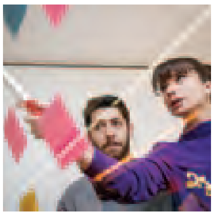
BRITISH AMERICAN
TOBACCO



Delivering today. Investing in tomorrow.

Annual Report 2013

This Annual Report outlines how our vision, strategy, business model and governance enable us to create value over the short, medium and long term – both for our shareholders and a wide group of stakeholders.

We describe our global operations for the year ended 31 December 2013, lay out our full financial statements and report in detail on the performance of the Group.

Our risks and opportunities are presented in a broad economic, social and environmental context and we make links between our financial and non-financial performance where appropriate.

We focus on those topics that British American Tobacco, in consultation with our stakeholders, deems to be most material to the sustainability of our business.

+ **Go online to view Our Year in Review 2013, featuring downloadable versions of this Report, along with a video review, our Sustainability Summary Report and other content – all accessible on desktop, tablet and mobile.**

www.bat.com/review2013

British American Tobacco p.l.c. (No. 3407696)
Annual Report 2013

This is the Annual Report of British American Tobacco p.l.c. (the Company) and the British American Tobacco Group, comprising the Strategic Report, Directors' Report and the audited Financial Statements, for the year ended 31 December 2013. It has been drawn up and is presented in accordance with, and reliance upon, applicable English company law. The liabilities of the Directors in connection with this report shall be subject to the limitations and restrictions provided by such law.

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

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

Cautionary statement

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

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

Delivering today. Investing in tomorrow.

> "Our ambition remains to lead our industry. We will do this by keeping the consumer at the heart of our business and focusing on delivering today's results as well as investing in our long-term success."

Nicandro Durante
Chief Executive

+ Read Nicandro's overview of our 2013 performance and outlook on page 06

What you will find in this report

Strategic Report

02 Our year in numbers
03 Chairman's introduction
04 Our global business
06 Chief Executive's overview
08 Industry trends
10 Our vision and strategy
12 Our business model
14 Our KPIs and business measures
15 Delivering our strategy
24 Key Group risk factors
30 Regional Review
36 Financial Review
pg 02 – 43

Governance

Directors' Report

44 Chairman's introduction
45 Leadership and responsibilities
46 Board of Directors
50 Board effectiveness
54 Audit and accountability
58 Corporate social responsibility
60 Appointments to the Board
61 Remuneration Report
105 Other disclosures
112 Responsibility of Directors
pg 44 – 112

Group Financial Statements

113 Independent auditors' report
117 Group Income Statement
118 Group Statement of Comprehensive Income
119 Group Statement of Changes in Equity
120 Group Balance Sheet
122 Group Cash Flow Statement
123 Notes on the accounts
200 Five-Year Summary
201 Half-Yearly Analysis of Profit
202 Principal subsidiaries and other Group undertakings
pg 113 – 203

Parent Company Financial Statements

204 Independent auditors' report
206 Balance Sheet – British American Tobacco p.l.c.
207 Notes on the accounts

Other information

210 Shareholder and contact information
pg 204 – 212

Our year in numbers

Group cigarette volumes, excluding associates (billion)

676

–2.7%

2012: 694

Profit from operations (£million)[1]

5,526

+3%

2012: 5,372

Basic earnings per share (pence)[1]

205.4

+5%

2012: 195.8

Revenue at constant exchange rates[2] (£million)

15,822

+4%

2012: 15,190

Adjusted profit from operations[3] **at constant exchange rates**[2] (£million)

6,041

+7%

2012: 5,641

Adjusted diluted earnings per share[3] (pence)

216.6

+6%

2012: 205.2

Revenue (£million)

15,260

+0%

2012: 15,190

Free cash flow (£million)

3,371

+3%

2012: 3,259

Dividends per share (pence)

142.4

+6%

2012: 134.9

Notes:
1. 2012 figures have been restated. See Note 1 on the accounts.
2. Constant currency provides the information based on a re-translation, at prior year exchange rates, of the current year information.
3. Adjusted profit from operations is derived after excluding the adjusting items from the profit from operations. These items include restructuring and integration costs, amortisation and impairment of trademarks and similar intangibles and a gain on deemed partial disposal of a trademark.

Chairman's introduction

> "I am confident that the Group is positioned to continue to deliver strong profit and dividend growth for many years to come."

Richard Burrows
Chairman

Strong growth

The Group has achieved another year of strong earnings and market share growth, despite difficult trading conditions in some parts of the world and unfavourable currency headwinds. Industry volumes continued to decline but the pricing environment remained strong. Good profit growth and a focus on asset management have also contributed to a continued improvement in return on capital employed, as detailed in our Financial Review.

It is to the great credit of our people, our management team and our Chief Executive, Nicandro Durante, that the business continues to deliver such strong results. The Group adopted a new vision and refocused strategy in 2013 and this has been embedded across the organisation, further sharpening our global alignment. We remain focused on investing in our tobacco business but recognise that beyond tobacco there are opportunities in the emerging next-generation product category.

Nicandro's overview of business performance in this Report describes how our strategy guides our global commercial operations and the roles new markets and new product categories will play in our future.

This success continues to deliver for our shareholders and is reflected in an increase of adjusted diluted earnings per share for 2013 to 216.6p, an increase of 6% on last year, or 10% on a constant currency basis.

The Board has recommended a final dividend of 97.4p per share, which will be paid on 8 May 2014 to shareholders on the register at 14 March 2014. This takes the total dividend for 2013 to 142.4p, an increase of 6% on 2012.

Our share buy-back programme continued in 2013. Between the beginning of March and the end of December 2013, almost 44 million shares were repurchased at a value of £1.5 billion, excluding transaction costs. The Board has agreed a further £1.5 billion share buy-back programme for 2014.

External recognition

I'm very pleased to report that, for the 12th successive year, British American Tobacco was selected in the 2013 Dow Jones Sustainability Index, where we remain industry leader. This recognises our continued achievements in our social and environmental performance.

As part of the refocusing of our Group strategy, we put an even greater emphasis on sustainability this year. We recognise that as a major international business we have responsibilities, from developing a new range of less harmful products and helping individuals make more informed choices, to supporting rural communities in the developing world.

Our efforts in these areas are discussed within this Strategic Report and elsewhere in our Annual Report, but we have also published a separate Sustainability Summary report called 'Value Shared'. This sits alongside the two Sustainability Focus reports we published in 2013, covering harm reduction and acting with integrity. You can download all three of these reports from our corporate website at www.bat.com/sustainability.

What guides us

Our Guiding Principles have long been at the core of our culture. They guide our behaviour and in this Strategic Report we describe how they align with our new vision. The Principles also underpin our approach to good corporate governance, as I have set out in my introduction to this year's Governance section in the Directors' Report.

Board changes

May I thank all of our Board members for their contributions during 2013. I am pleased to report that we maintain our strong record on Board diversity, both in gender and in the wide range of backgrounds and nationalities represented among our Directors.

My thanks go to Anthony Ruys, who will stand down as a Non-Executive Director at the conclusion of this year's AGM having served for eight years on your Board.

Also to John Daly, who stepped down as Chief Operating Officer at the end of December to focus on the transitioning of key projects and initiatives in early 2014. He will retire from the Board in April 2014. John has held many senior management roles during his 19 year career with British American Tobacco. He will be missed by colleagues throughout the organisation and I join them in wishing him well for his retirement.

I am also delighted to welcome Savio Kwan, who joined our Board as a Non-Executive Director in January 2014. Savio brings us his profound commercial approach, a clear international orientation and his significant business experience of Greater China and Asia, further strengthening British American Tobacco and the Board.

Strong position

While 2013 has been a successful year, it has been a tough one too. As for 2014 and beyond, I know our management team and our people are ready to meet the challenges ahead and to take advantage of new and existing opportunities. I am confident that the Group is positioned to continue to deliver strong profit and dividend growth for many years to come.

Richard Burrows
Chairman

Our global business

British American Tobacco is a global tobacco group, with brands sold in more than 200 markets. We employ more than 57,000 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.

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 high growth markets and new product categories will help us drive growth and build shareholder value in the years ahead.

+ **Our business model:**
page 12

Our heritage

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 in 2013 the Company was one of the top 10 listed on the London Stock Exchange. We also have a secondary listing on the JSE Limited in South Africa.

Our international brands

Dunhill, Kent, Lucky Strike and Pall Mall are our Global Drive Brands (GDBs). They are recognised as our leading brands globally.

We review our brands from time to time to assess performance and increase focus for investment. As a result, from 2014 we have added Rothmans to our GDBs.

We have many other famous international brands, including State Express 555, Vogue, Viceroy, Kool, Peter Stuyvesant, Craven A, Benson & Hedges and John Player Gold Leaf.

Dunhill

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

Number of markets where Dunhill is sold

110+

DUNHILL SINCE 1907

Kent

Kent symbolises progress through technology in the cigarette category and stands out as the most innovative and forward-looking brand in the industry. A pioneering brand, leading the way since 1952.

Number of markets where Kent is sold

80+

KENT

Rothmans

Rothmans dates back to 1890, when it was established in London by its founder, Louis Rothman. It has now been repositioned as a contemporary brand with a strong heritage, and is finding increasing appeal with consumers around the world.

Number of markets where Rothmans is sold

60+

Rothmans

Lucky Strike

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

Number of markets where Lucky Strike is sold

70+

LUCKY STRIKE

Pall Mall

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

Number of markets where Pall Mall is sold

100+

PALL MALL

+ **Growth:**
page 15

Our sustainable approach to business

We manage our supply chain and the environment responsibly, leading in product expertise and working directly with over 100,000 independent farmers worldwide. Our approach to marketing leads our industry, in brand building, innovation and responsibility. Our companies adhere strictly to the high standards of our voluntary marketing principles. We are also proud of our Research & Development facilities, where our people are endeavouring to reduce the harm associated with tobacco products.

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. In 2013, our subsidiaries enabled governments worldwide to gather more than £33 billion in duty, excise and other taxes on our products, which is eight times the Group's profit after tax.

+ **Sustainability:**
page 22

Our products

Traditional tobacco products

We continue to deliver good growth across our core tobacco product range. This includes cigarettes, Fine Cut (roll-your-own and make-your-own) tobacco, cigars, cigarillos, pipe tobacco and snus.

Next-generation products

We are also investing in building a portfolio of innovative new tobacco and nicotine-based products alongside our traditional tobacco business. These next-generation product lines include nicotine inhalation, heat-not-burn devices and electronic cigarettes.

Quality assured

Our market-leading innovations help to differentiate our products. We rely on a fully integrated global supply chain and use our expertise in leaf to secure supply and improve product quality.

+ **Productivity:**
page 18

Geographic diversity

We're a diverse business and our people operate in a huge range of environments, from city offices to remote farms.

We have strong market positions in each of our four regions. Our key markets, shown here, account for around 80% of our total volume and around 85% of Group profit.

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

+ **Regional Review:**
page 30

+ **Winning organisation:**
page 20

62

Markets where we are leader

46

Cigarette factories in 41 countries

Asia-Pacific

Key markets

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

Americas

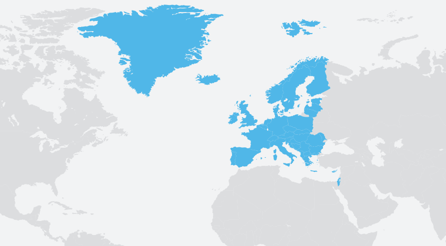
Key markets

Argentina
Brazil
Canada
Chile
Colombia
Mexico
Venezuela

Western Europe

Key markets

Belgium
Czech Republic
Denmark
France
Germany
Italy
Netherlands
Poland
Romania
Spain
Sweden
Switzerland
UK



Eastern Europe, Middle East and Africa

Key markets

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

Chief Executive's overview

> "Our strategy is delivering today and I firmly believe it will continue to deliver long-term value to shareholders and a wide group of stakeholders."

Nicandro Durante
Chief Executive

We're delivering today and investing in tomorrow

British American Tobacco had another very good year in 2013, again meeting or exceeding our financial metrics.

Revenue and market share continued to grow. Together our Global Drive Brands (GDBs) – Dunhill, Kent, Lucky Strike and Pall Mall – increased share and volume.

It was a challenging year for our people globally, but they responded with the enterprise and commitment I have come to expect. We adapted to changes in our business environment, faced some tough trading conditions and embraced a range of new opportunities, in both new product categories and new markets. We invested further in our existing key high growth markets, too.

We also adopted a new vision in 2013, along with an enhanced strategy that better reflects the evolving needs of our consumers. This strategy is enabling us to respond even more rapidly to the opportunities and challenges we believe are important to a 21st century tobacco company committed to investing in its future.

We're committed to delivering value

Our new vision is to be the "world's best at satisfying consumer moments in tobacco and beyond." Our ambition remains to lead the global tobacco industry. We will do this by keeping the consumer at the heart of our business and focusing on delivering today's results as well as investing in our long-term success.

I am as confident as ever in the growth of our tobacco business. Pricing remains good and despite the industry volume decline, the global cigarette market is growing in value. New investments will also contribute to future growth, such as our joint operation with subsidiaries of China National Tobacco Corporation, which commenced operations during 2013.

There are also opportunities in nicotine-based products. We launched Vype, our first electronic cigarette, in the UK in 2013, making us the first international tobacco business to enter this new market.

Our strategy is delivering today and I firmly believe it will continue to deliver long-term value to shareholders and a wide group of stakeholders.

We've achieved another year of strong results

The Group's strong performance in 2013 was achieved against a backdrop of adverse exchange rate movements, lower industry volume and instability in some parts of the world.

At constant rates of exchange, revenue was up by 4% and adjusted profit from operations was up by 7%. Adjusted diluted earnings per share was up by 6% at current rates or 10% at constant rates of exchange.

Our adjusted operating margin improved significantly by 100 basis points, at the top end of our guidance of an increase of 50 to 100 basis points each year. This was achieved thanks to efforts right across our global organisation to address our cost base, to standardise our systems and deliver productivity savings year on year. A strong price mix of 7% has also contributed to this excellent result.

Our return on capital employed (ROCE) has also improved considerably over the past few years. We have seen a steady increase in ROCE from 23% in 2009 to 31% in 2013, demonstrating that our investments are delivering growth.

We're growing market share

In 2013 we successfully grew our market share in our key markets by 20 basis points, driven by the success of our GDBs, which were up by 60 basis points. Our share of the premium segment also grew by 80 basis points. However, cigarette volume from subsidiaries was lower by 2.7%, mainly as a result of industry declines.

Our international brands grew volume by 2.1%, of which our GDBs grew by 1.9%. Dunhill volume was up by 9.7% and Pall Mall grew by 4.4%. Kent's was 2.9% lower while Lucky Strike volume was down by 6.5%. Collectively, our GDBs now account for 35% of our total volume.

From 2014, we have added Rothmans to our portfolio of GDBs, recognising the brand's strategic value to the Group.

Other tobacco products also performed very well, particularly Fine Cut tobacco, which was up 1.3% in Western Europe, driven by the continued success of Pall Mall and Lucky Strike in this category.

We're focusing on the consumer

Our success is down to our determination that the consumer should be at the centre of everything we do. We have greatly improved our understanding of consumers in the past few years, building on what was already a great strength of our business. This is vital in helping us address consumers' evolving needs and concerns.

We want to do this in "tobacco and beyond", addressing the emerging category we see in nicotine products. Tobacco remains our core business and will continue to drive growth in the future. However, the consumer demand for next-generation products offers us new growth opportunities in which to flex the organisation's capabilities and global reach.

We support sound regulation based on robust evidence

We support sound regulation backed by robust evidence and thorough research that shows it will help achieve the objective of reducing the harm resulting from tobacco use. However, measures such as excessive excise increases on tobacco products and plain packaging do more to disrupt orderly markets and little to further their intended aims.

In fact, they create ideal conditions for counterfeiters and smugglers to thrive. We are committed to leading our industry and providing a template for others by engaging openly on regulatory issues, while also working with global partners to fight the illegal tobacco trade.

We look to the future with confidence

Challenges persist in 2014. Economic recovery is still fragile, particularly across southern Europe. However, we have shown a consistent ability to improve our operating margin and grow market share. The pricing environment also remains good.

We have a great brand portfolio, market-leading innovations and an outstanding range of high-quality products. We maintain our firm commitment to invest in key growth markets and new product categories. Our scientific research into harm reduction, for instance, is helping us develop next-generation tobacco products, such as heat-not-burn, and nicotine products, like e-cigarettes.

In short, we have the expertise, the talented people and the global reach to succeed. Consumers have always been core to our success. We will continue to meet their needs by providing them with the superior and innovative products they want. We have a compelling strategy and proven capabilities in place to make this happen. I look forward to a gradually improving economic environment and BAT is well positioned to take advantage of this when it comes.

Nicandro Durante
Chief Executive

Global Drive Brand 2013 performance

Dunhill cigarettes sold
(billions)

54

+9.7%

Kent cigarettes sold
(billions)

65

–2.9%

Lucky Strike cigarettes sold
(billions)

31

–6.5%

Pall Mall cigarettes sold
(billions)

87

+4.4%

Rothmans
From 2014, we have added Rothmans to our portfolio of GDBs.
In 2013, we sold 26 billion Rothmans cigarettes.

Industry trends

Global cigarette market

Globally, around 6,000 billion[1] cigarettes are sold each year. 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, which is around 75% of the market outside China.

China is the biggest single tobacco market, with some 350 million smokers who account for more than 40% of global consumption. The state-owned China National Tobacco Corporation (CNTC) is the world's largest tobacco company.

Growth in tobacco and beyond

The value of the global tobacco market is estimated at £450–500 billion[1]. While cigarette volumes in developed countries continue to decline year on year, the overall value of the tobacco market continues to grow.

Longer-term trends will see fewer smokers as a percentage of the population, but we believe that global population growth, consumer demand for premium and innovative tobacco products, and emerging next-generation product categories will provide strong growth opportunities in the years to come.

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. Even in countries that do not have tobacco manufacturing or leaf growing, tobacco retail and distribution is an important source of economic activity.

Tobacco taxes are a major source of revenue for almost every government in the world and have been an especially important source of funds during difficult economic conditions in recent years. It is estimated that governments worldwide collect around £150 billion in excise on the sale of tobacco products each year.

British American Tobacco alone contributed more than £33 billion to governments in excise and other taxes in 2013 – that's eight times the Group's profit after tax.

The choice to grow tobacco

Less than 1% of the world's agricultural land is used for tobacco farming and only for part of the year, yet it is an important contributor to the agricultural economy in many countries. Farmers choose to grow tobacco because it's hardy, does well in poorer soils, can cope with volatile weather and is known for fetching stable prices.

To help farmers make better use of their land and to help ensure the long-term sustainability of our leaf supply, at British American Tobacco we've built up a skilled network of local field technicians. They visit farmers and show them how to improve their tobacco yields from small plots, while using the rest of their land to grow other crops such as maize, cereals, fruit and vegetables.

Tobacco litigation

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

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

Tobacco companies worldwide continue to defend themselves against litigation, drawing confidence from the industry's exceptionally good record.

> The global tobacco industry contributes substantially to the economies of more than 100 countries, and millions of people worldwide depend on it for employment.

Regulating the tobacco market

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 can have unintended consequences.

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

Australia is the only country to have introduced plain packaging. Since it was introduced in December 2012 there has been no real evidence that plain packaging has achieved its aims of reducing consumption or been effective in preventing youth smoking. What we have seen is an increase in the illegal market. Plain packaging also breaches intellectual property rights and international trade agreements. The governments of Ukraine, Cuba, Honduras, the Dominican Republic and Indonesia are challenging Australia's plain packaging laws at the World Trade Organization.

Tobacco trafficking

The illegal market in tobacco products accounts for up to 660 billion[2] cigarettes every year globally, depriving governments of around £30 billion in legitimate taxes. This illegal trade is also a huge competitor for the legal tobacco industry itself, and takes away a significant amount of legitimate business each year. The profits often end up in the hands of criminals who don't pay tax and sell their products to anyone, including children.

Tobacco trafficking also has a negative impact on consumers, retailers and regulators. Counterfeit cigarettes mean no quality controls and no health warnings, while smuggled genuine products are unlikely to carry health warnings that meet local government regulations.

The industry has worked together on initiatives across the whole supply chain that are designed to stop criminals. These include technological developments such as digital coding and tax verification, which help governments ensure taxes and duties are paid, and a track and trace system, which means we can monitor the movement of our products.

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

The case for next-generation products

Scientists widely agree that it is the toxicants in tobacco smoke, not the nicotine, that causes the overwhelming majority of smoking-related diseases. Conventional cigarettes carry the most risks to health, while some forms of low-toxicant smokeless tobacco products, although not risk-free, are much less risky. Regulatory-approved nicotine products that contain no tobacco or smoke toxicants are almost risk-free.

The development and bringing to market of a range of products that meet the needs of adult smokers seeking safer alternatives to cigarettes, would help to meet the objectives of many leading public health professionals. It would also make good commercial sense to a business like ours.

At British American Tobacco, our aim is to improve e-cigarettes and other nicotine products to make them more satisfying for consumers. Our experience and capabilities also mean we can make improvements in areas such as product quality. While for regulators and governments, endorsing less risky, alternative products could be a positive move towards making tobacco harm reduction a key public health policy objective.

The choice between the legal tobacco industry and the illegal market

Our world – responsible, open and transparent	Harm reduction is core to our business strategy and we invested £161 million in 2013 in research and development.	Responsible marketing aimed only at existing adult smokers and a global approach to youth smoking prevention.	Products highly regulated and we have strict quality and safety standards.	We paid more than £33 billion to governments globally in excise and other taxes in 2013.	Fair treatment of farmers, suppliers and employees. We also provide direct agronomy support to over 100,000 farmers worldwide.
		18		£	
The world of the illegal tobacco market	No contribution to harm reduction.	Active marketing and selling of tobacco products to children.	Poor quality products with no regulation or standards and potentially higher health risks than legal cigarettes.	Large-scale tax evasion.	Poor working standards, financial security and negotiating powers for farmers and workers throughout the supply chain.

Notes:

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

Our vision and strategy
Delivering shareholder value

We adopted a new vision in 2013 and enhanced our strategy to better reflect the evolving needs of consumers. These have been embedded across our business and they help us create long-term value for our shareholders and a wide group of stakeholders.

Our strategy

Our strategy enables our business to deliver growth today, while ensuring we generate the funds to invest in our future. Tobacco remains at the core of our business and will continue to provide us with opportunities for growth.

Our vision lies at the heart of our strategy and underlines the importance of grasping new opportunities in tobacco and beyond.

Our strategy defines our mission and, through our Guiding Principles, it also guides our behaviours and activities, helping us to maintain a sustainable approach that will guarantee our future as a 21st century tobacco business.

Our vision

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

Satisfying consumer moments

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

In tobacco and beyond

The second part of our vision – tobacco and beyond – recognises the strength of our traditional tobacco business and addresses the emerging opportunities we see in next-generation products. There is a great potential business opportunity here with emerging product categories in which we are uniquely placed to succeed.

Our mission

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

Champion informed consumer choice

We need to continue to ensure that our consumers are fully informed about the choices they are making when they purchase our tobacco products. We recognise that we have a responsibility to offer a choice of products across the risk spectrum, but we will also defend their rights to choose and provide them with the products they want.

Deliver our commitments to society

As society changes, and people's priorities and needs shift, we need to be ready to meet new challenges and take advantage of new opportunities. We are a major international business and with this status comes responsibilities, from being open about the risks of our products, to supporting rural communities in the developing world.

Strategic focus areas

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

+ See Delivering our strategy on pages 15–23

Growth

Understanding and delivering enjoyable consumer moments.

Productivity

Effectively deploying resources to increase profits and generate funds.

Winning organisation

Great people, great teams, great place to work.

Sustainability

Ensuring a sustainable business that meets stakeholders' expectations.

Guiding Principles

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

Enterprising spirit

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

Freedom through responsibility

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

Open minded

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

Strength from diversity

We employ people from more than 150 nations, giving us unique insights into local markets and enhancing our ability to compete across the world. We respect and celebrate each others' differences and enjoy working together. We harness diversity – of our people, cultures, viewpoints, brands, markets and ideas – to strengthen our business. We value what makes each of us unique.

Our business model
Creating value over the long term

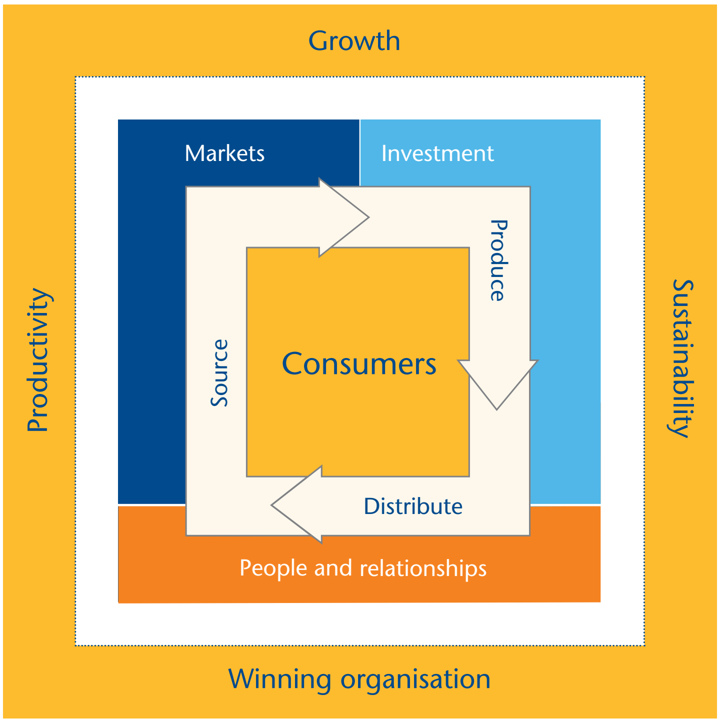
Our business model and strategy delivering value

Our business model describes what we do and, more importantly, how we use our unique strengths and employ our resources and relationships to deliver sustainable growth in earnings for our shareholders. It is built around meeting our consumers' evolving needs and is driven by our strategy to ensure that we are delivering great results today and investing in our long-term future.

What we do

Essentially, we make and market cigarettes globally, but there's a lot more to it than that.

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



Source

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

+ **Working with farmers:** pages 18–19

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

Produce

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

+ **Global scale:** pages 04–05

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

Distribute

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

+ **Raising standards:** pages 22–23

We are helping to raise standards by supporting regulation of conventional cigarettes and a new generation of products. That means fighting the illegal tobacco market and supporting legitimate retailers and wholesalers.

Consumers

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

+ **Developing solutions:** pages 15–17

We are developing innovative solutions to evolve our brand portfolio and create more differentiated products. This supports our aim to champion consumer choice and provide a range of products across the risk spectrum.

What makes us different

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

What guides us

Our Guiding Principles define how we behave and how we govern our business:

Enterprising spirit
Open minded
Freedom through responsibility
Strength from diversity

+ **Read about our Guiding Principles in Our vision and strategy** pages 10–11

Markets

Brands

We have a successful brand marketing strategy based on sound consumer insights. It is driven by our Global Drive Brands – Dunhill, Kent, Lucky Strike and Pall Mall – which account for more than a third of the total cigarettes we sell. Our portfolio of more than 200 international, regional and local brands is designed to meet a broad array of consumer preferences around the world. We also launched Vype in 2013, our first brand in the emerging e-cigarette market.

Products

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

Global presence

With over 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 and continue to provide opportunities for growth. We hold robust market positions in each of our regions and are leaders in more than 60 markets.

+ **Fighting the illegal trade in tobacco:** pages 09 and 25

We work with other tobacco companies and enforcement agencies to combat the threat that trafficking faked or smuggled tobacco goods presents to our business, to governments and to our consumers.

Investment

Innovation

We make significant investment in research and development to deliver innovations that satisfy or anticipate consumer needs and generate growth for the business. This involves 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.

Selected investments

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

World-class science

We have an extensive scientific research programme. We have been focusing research on innovative less risky tobacco and nicotine 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 bring reduced-risk products to market.

+ **Investing in our long-term future:** pages 36–43

Access to cash and other sources of finance is essential for funding our local operations. We have the controls in place and manage our cash resources effectively to ensure that we can also invest in our long-term future.

People and relationships

Our people

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

Our suppliers

We don't own tobacco farms, but we provide agronomy support through our extension services. Our Social Responsibility in Tobacco Production programme encourages continual improvement of the social and environmental performance of the suppliers we buy tobacco leaf from. Through our relationship with leaf suppliers and tobacco farmers we are mitigating the negative social and environmental impacts that tobacco growing can have and helping to provide a reliable source of income that can help support food security.

Our wholesalers, distributors and retailers

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

+ **Supporting people and communities:** pages 20–21

We are committed to safeguarding the health, safety and welfare of the people who work for the Group or alongside it as contractors of partners in our operations. We also play a full role in the communities we work in.

Our KPIs and business measures

We have a wide range of measures and indicators by which we assess performance. To ensure management's focus is aligned with the interests of our shareholders, our KPIs (key performance indicators) are reflected in our management incentive schemes.

Although our other financial and sustainability measures are not directly included in these incentives, we believe these business measures reflect our performance, improve the quality of our business and contribute to shareholder value, particularly over the long term.

We review these measures periodically and update them to ensure they remain relevant and reflect the needs and priorities of the business.

Key performance indicators (KPIs)

	Relevant strategic focus area	**Page**
Group share of key subsidiary markets	Growth	+ Page 16
Global Drive Brand (GDB) volumes	Growth	+ Page 16
Adjusted diluted earnings per share (EPS)	Growth	+ Page 16
Total shareholder return	Growth	+ Page 17
Adjusted profit from operations	Productivity	+ Page 19
Cash generated from operations	Productivity	+ Page 19

Business measures

	Relevant strategic focus area	**Page**
Net turnover (NTO)	Growth	+ Page 17
Operating margin	Productivity	+ Page 19
Free cash flow as a percentage of adjusted earnings	Productivity	+ Page 19
Employee engagement index	Winning organisation	+ Page 21
Carbon dioxide equivalent (CO_2e)	Sustainability	+ Page 23
Group energy use	Sustainability	+ Page 23
Water use	Sustainability	+ Page 23
Recycling	Sustainability	+ Page 23

Delivering our strategy

Growth

We provide high quality, relevant tobacco and nicotine-based products that meet consumer needs. We do this by being brand focused and excelling at bringing superior, differentiated offers to market.

What we do

Understanding consumers is at the core of Group strategy and our success depends on delivering high-quality tobacco and nicotine products that meet their evolving needs. We aim to achieve responsible leadership in consumer and trade partner engagement, including through new retail channels.

We delivered in 2013

Our well-balanced brand portfolio delivered good profit growth in 2013, led by another great contribution from our Global Drive Brands (GDBs) – Dunhill, Kent, Lucky Strike and Pall Mall. Pricing remained strong despite a challenging trading environment.

We saw volume growth in many markets, including Bangladesh, Pakistan, Indonesia, the Middle East, Vietnam and the Philippines. However, volume was lower in Brazil, Russia, Turkey, Ukraine, Egypt and Western Europe. Overall cigarette volume from subsidiaries was 676 billion, down by 2.7%, largely as a result of industry volume declines. Total tobacco volume (including cigarettes and other tobacco products) was also 2.6% lower than last year.

Our GDBs and innovations are delivering growth

The investments we have made in our GDBs have seen their share of our global volume more than double to 35% since 2003. GDB volume growth of 1.9% in 2013 was driven by consumer-relevant innovations and our GDB market share grew strongly in the Group's key markets. GDB Fine Cut products performed well, too, with volume increasing by 7.5% in 2013.

Innovations, such as capsules, resealable packaging and new filter technologies, accounted for almost one-fifth of our total cigarette volume and grew by 19.7% in 2013. We continue to be the market leader for capsule products, with a segment share of 46% in our key markets.

Dunhill, our most prestigious brand, delivered volume growth of 9.7% to 54 billion cigarettes in 2013. This excellent result was driven by very strong performances in Indonesia, South Korea and the Gulf Cooperation Council (GCC) countries, partially offset by declines in Malaysia and West Africa. Innovations accounted for 81% of Dunhill's 2013 volume, with 76% of all Dunhill cigarettes now sold in our innovative resealable Reloc packaging.

Kent is our most innovative and forward-looking brand, and innovations now account for 77% of the brand's global volume. Overall volume in 2013 was 65 billion, down by 2.9% due to declines in Russia, Japan and Romania, partially offset by growth in the Middle East and Uzbekistan. However, we continue to expand our offerings in Kent Convertibles and 2014 has already seen more launches in the Kent HD range, featuring new filter technology that will further enhance the brand.

Lucky Strike, our original American brand, saw volume fall by 6.5% to 31 billion cigarettes. The fall was driven by an industry decline in Spain, although the brand grew significantly in the Philippines and Russia in 2013. Innovations now account for 29% of this volume, including our 'all natural' offer, which continues to provide opportunities for growth. Lucky Strike Fine Cut also had a successful year, with volume up by 7.3%, driven by gains in Italy, Belgium, Spain and France.

Pall Mall, our leading brand in terms of volume, grew by 4.4% in 2013, delivering a record volume of 87 billion cigarettes, due to increases in Chile, Pakistan and Argentina. This was partially offset by lower volumes in Russia, Serbia, Italy and Hungary. Innovations accounted for 16% of Pall Mall's cigarette volume, while Pall Mall Fine Cut volume was up by 7.5% in Western Europe, mainly driven by growth in Germany, Belgium, Spain, the Netherlands and France. Pall Mall is the biggest Fine Cut brand in Western Europe.

We are investing in our brand portfolio

In addition to our existing GDBs, we continue to invest in a strong portfolio of international brands such as Rothmans, Peter Stuyvesant, State Express 555, Kool, Benson & Hedges, Craven A and John Player Gold Leaf.

Rothmans volume was up by 21.7% in 2013, reaching a total of 26 billion cigarettes – adding 3.9 billion cigarettes in Russia alone and building on the brand's very successful launch there in 2012. The brand also increased its footprint with volume growth in Ukraine, Algeria and Italy. Rothmans became part of our portfolio of GDBs at the start of 2014, recognising the brand's strategic value to the Group.

Gains in Vietnam helped drive volume growth of 26.8% to 6 billion cigarettes for State Express 555. This brand was further boosted in 2013 when CTBAT International Limited, our joint operation with subsidiaries of China National Tobacco Corporation, commenced business operations. CTBAT now owns and manages the worldwide international rights to State Express 555. It also owns the worldwide rights outside China to the leading Chinese brand Shuang Xi.

John Player Gold Leaf continues to be a very important regional brand in Asia-Pacific and the Middle East, growing by 7.4% in its key markets of Pakistan, Bangladesh and the GCC. However, Kool volume fell in Japan and Peter Stuyvesant volume was down in South Africa and Greece.

Benson & Hedges grew in several markets, but overall volume fell slightly due to market declines in Bangladesh and Australia. Craven A, another important brand in our Asia-Pacific and Eastern Europe, Middle East and Africa (EEMEA) regions, grew by 1%.

In 2013, the Group launched its first next-generation product, an e-cigarette called Vype, which is intended to offer smokers a less risky alternative to traditional cigarettes. A rechargeable version of Vype has already been launched to enhance the range.

Delivering our strategy
Growth continued

We're building partnerships

Building partnerships with retailers is a key part of our trade marketing activities. Globally, we have around 20,000 Trade Marketing & Distribution (TM&D) employees responsible for the selling and delivery of our products, managing our brands at the point of sale and developing mutually beneficial partnerships with our trade customers.

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.

It also involves engagement in the prevention of youth smoking and tobacco trafficking. We expect retailers and wholesalers to take their responsibilities very seriously in these areas and work hard with them to try and eradicate both of these problems.

Where appropriate, we use direct-to-store sales (DSS) in our distribution network. 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. 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.

We're investing in our future

Our well-balanced brand portfolio, clear consumer understanding and strong trade marketing capabilities have provided us with a firm foundation for growth for many years. We are committed to investing further in our brands and capabilities, in new and existing markets in tobacco and beyond.

We continue to invest in our high growth markets, while supporting our GDBs and focusing on innovations, and we see a very strong future for our tobacco business.

It is also our intention to bring to market a much wider selection of next-generation tobacco and nicotine-based products to complement our existing tobacco brands, broadening consumer choice with a range of high-quality products that they can trust.

Supporting our brands and innovations in a fast-paced and rapidly changing retail environment continues to be a key focus. A programme we rolled out in 2013 called 'Positive' provides training for our people, better equipping them to meet the needs of their trade customers and our consumers.

Key performance indicators (KPIs)

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

+0.2%

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

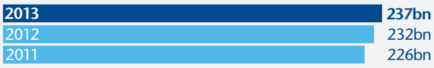
Target: To continue to grow market share.

Note: *Share figures are rebased annually to reflect market and segment size changes. We do not show comparators here, as previous years' figures are not calculated on the same basis.

Global Drive Brand (GDB) volumes

237bn

+1.9%

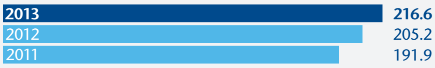


Definition: GDB volumes are calculated as the total volumes of the four GDBs – Dunhill, Kent, Lucky Strike and Pall Mall – sold by our subsidiaries.

Target: To increase our GDB share faster than the rest of our portfolio.

Adjusted diluted earnings per share (pence)

+6%



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

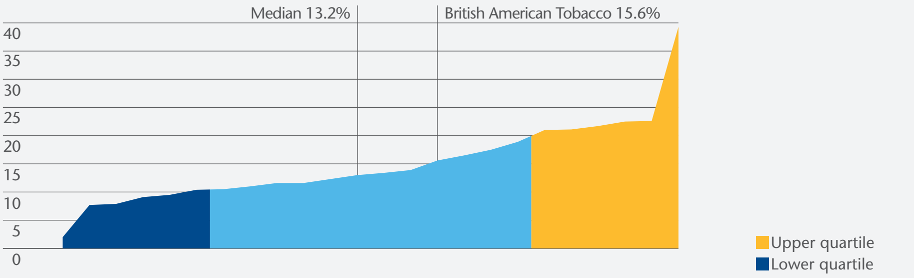
Key performance indicators (KPIs)

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

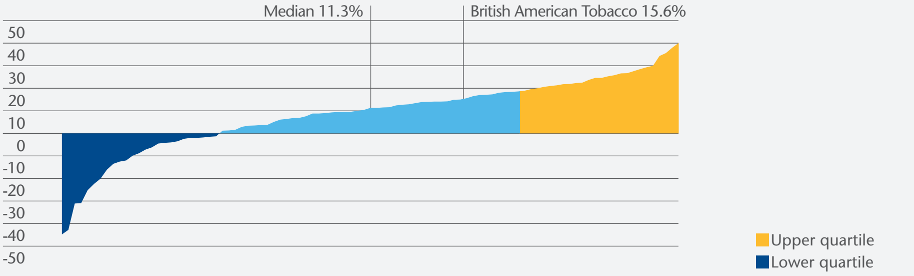
Definition: Total shareholder return (TSR) is measured according to the return index calculated by Datastream, on the basis of all companies' dividends being reinvested in their shares. The return is the percentage increase in each company's index over a three-year period.

Objective: The Group is focused on increasing shareholder value, which is measured using TSR compared to the FTSE 100 Index and also to a fast-moving consumer goods (FMCG) peer group. The FMCG comparator group is reviewed annually to ensure it remains both relevant and representative.

FMCG group – 1 Jan 2011 to 31 Dec 2013
The FMCG group comparison is based on three months' average values (annual %)



FTSE 100 – 1 Jan 2011 to 31 Dec 2013
The FTSE 100 comparison is based on three months' average values (annual %)



Business measures

Net turnover (NTO) at constant exchange rates

£15,822m

+4%

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

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

Delivering our strategy

Productivity

By effectively deploying our resources we can increase profits, improve our operating margin and generate funds to invest in our business, helping us to grow market share and achieve higher returns for shareholders.

What we do

We rely on a highly integrated global supply chain and use our expertise in leaf to secure supply, improve product quality and differentiate our products. Our environmental management systems and business controls help us and our suppliers to increase effectiveness and efficiency. We are also implementing a new global operating model with common systems, processes and ways of working.

We made further progress in 2013

Productivity is a vital enabler in our business and remains a very important aspect of our strategy. Our integrated supply chain enables the group to deliver growth. Improving efficiency and effectiveness in 2013 has also allowed us to roll out innovations faster and implement machine technology standards – enhancing our sourcing flexibility, contingency planning and capital effectiveness.

The transparency of demand and supply at a global level through sales and operational planning ensures we are able to move quicker and make better decisions when allocating resources.

We're better, faster and more effective

The Group's ambitious programme to implement a new operating model globally began in 2012. The programme includes revised organisational structures, standardised processes and shared back-office services, underpinned by a global SAP system.

New structures and processes are being implemented in phases throughout the organisation and the deployment of the new SAP system, which began in late 2012, was ongoing throughout 2013. The first market implementation was in Malaysia, followed by Australasia, while South Asia – Sri Lanka, Bangladesh and Pakistan – went live with the new system on 1 January 2014.

The programme will take a further three years to fully roll out worldwide, but the new model is already delivering benefits, bringing with it a clear focus on how to do things better, faster and more effectively. The next big milestone in the programme is planned for mid-2014 when the new operating model will be implemented across the rest of our Asia-Pacific region, with the exception of Indonesia.

We're delivering operating margin improvements

Better cost management helped to deliver an improved operating margin of 38.1% in 2013. We continue to improve our marketing efficiency and capital effectiveness, including reducing unnecessary complexity to save costs and using our cash and assets more effectively.

We're investing in our supply chain

Our proven expertise in tobacco leaf means we are ideally placed to address evolving consumer needs, while factoring in the implications of changes in product-based regulation. By managing our leaf footprint carefully, we can ensure sustainability of supply and guarantee our access to quality sources of leaf.

We invest in the quality of our leaf, through our people on the ground and their relationships with local farmers. However, our above-market planning and the global visibility of our leaf pool further drives cost efficiencies and helps to provide us with a competitive advantage.

We support farmers

We don't own tobacco farms or directly employ farmers; instead, we work as partners with over 100,000 smallholder farmers worldwide, who supply over 60% of the tobacco leaf we buy. Our leaf technicians work in the field with them, agreeing contracts, supplying seed and offering advice on propagation, the safe use of agrochemicals and integrated pest management.

We're also helping farmers to farm more sustainably by developing new methods that suit them and their environments. For example, the farmers we work with have reduced their use of natural forest for curing fuels down to only 1.3% of total wood used. We aim to reduce this further. To compensate for those trees that have been felled, we have planted over 170 million trees through our afforestation programmes in the last six years.

Our Social Responsibility in Tobacco Production (SRTP) programme sets out the minimum standards we expect of our leaf suppliers. It covers good agricultural practices, occupational health and other social issues such as human rights, labour standards and eliminating child labour, as well as the protection of biodiversity. It has proved so successful that it's now been adopted as the industry standard.

We're driving efficiency in our manufacturing

We continue to optimise our manufacturing footprint and now run 46 cigarette factories in 41 countries. This compares to the 87 factories we operated around a decade ago, if you include those we have taken over due to acquisitions.

Consolidation and restructuring of factories around the Group continues to be undertaken responsibly and with care for affected employees and local communities. Our leading factories now serve multiple markets and produce wider ranges of products across our brand portfolio. They are managed through our above-market operations.

We're serious about supply chain security

Working alongside other international tobacco companies, we are developing new industry-wide supply chain security systems to guard against theft and the risk of our products falling into the hands of tobacco traffickers. Digital coding technology helps governments ensure that all taxes and duties are paid on our products, while sophisticated identifiers on packs allow consumers and authorities to validate a product's authenticity.

Track and trace technology allows us to track the forward movement of our products through our supply chain. If a product is seized by customs or enquired about by the authorities, we can trace it backwards and determine the point at which the product may have left the legitimate supply chain. The successful implementation of track and trace technology means that we can comply with a Cooperation Agreement to fight illicit trade that the Group signed with the European Union in July 2010.

Track and trace was implemented by our companies in Germany and Romania in 2013. The system has now been implemented across our global travel retail business, five markets and four factories in three other countries. We have a well-structured plan in place to deploy the system further, with the support and cooperation of our logistics suppliers.

Investing in productivity

Still in its initial phase in 2013, our new global operating model has already started to deliver benefits around cash and cost efficiencies. As the roll-out continues in 2014 and 2015, we expect to see improvements in the way our people and business units work globally.

By realising further productivity savings from our supply chain, including indirect material procurement and overhead savings, we can continue to release funds that the Group can invest in our brands, our product innovations and our key growth markets. We can also invest in our people and their capabilities to ensure they can drive growth by enhancing the consumer experience.

Key performance indicators (KPIs)

Adjusted profit from operations at constant exchange rates

£6,041m

+7%

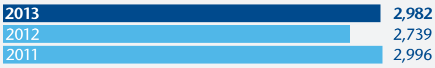
Definition: This is the adjusted profit from operations of the Group's subsidiaries – profit from operations at constant rates adjusted for the items shown as memorandum information on the Group Income Statement.

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

Note: Comparator has been restated.

Cash generated from operations

£2,982m



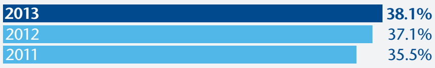
Definition: Cash generated from operations is defined as the free cash flow excluding restructuring costs and dividends and other appropriations from associates, per the alternative cash flow on page 41.

Target: A specific target is set each year for the cash flow from operations. The target for 2013 was exceeded.

Business measures

Operating margin

38.1%



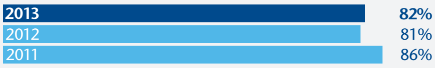
Definition: This is the percentage of adjusted profit from operations divided by revenue.

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

Note: Comparators have been restated.

Free cash flow as a percentage of adjusted earnings

82%



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

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

Delivering our strategy

Winning organisation

Our reputation as a leading business helps us stand out in an increasingly competitive international employment market. We value the diversity of our employees and encourage enterprising behaviour.

What we do

Our aim is to maintain a high-performing organisation that can attract, develop and retain the next generation of leaders. British American Tobacco is a great place to work, with great people and great teams who share this view. They embrace our culture of personal ownership and value the opportunity to be entrepreneurial in a challenging business environment.

Our organisation in 2013

We ran a major programme in 2013 to embed our updated vision and strategy and this has seen our people embrace our Guiding Principles. These provide clarity about what we stand for and act as a compass to guide our behaviour. Our Guiding Principles are Enterprising Spirit, Freedom Through Responsibility, Open Minded and Strength From Diversity – see page 11 for more information.

We're committed to diversity

For us, progress on diversity starts from the top and is driven by the Management Board. Our leadership teams are committed to fostering diversity and each of our business units is required to develop specific diversity plans, aligned to their priorities. Their progress against these plans is then reported back to the Management Board.

Our diversity ambition is to achieve by 2020 a sustainable improvement in senior representation of women and nationalities that are key to our success based on merit, and thereby better reflect the diversity of our consumers and customers in our employees, our culture and the way we operate.

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

Our diversity policies and approach are built around the following key principles:

- We make merit-based decisions – our aim is to narrow the gap between the current situation and our diversity aspirations, without compromising on talent and capabilities.
- We aim to build a diverse workforce, including but not limited to gender and nationality diversity.
- We are committed to an inclusive culture that will tackle prejudice and promote understanding.
- We ensure that there is a level playing field – so that our people have equal opportunities to succeed and to advance their careers.

Local staff account for around 60% of employees on top teams around the world and diverse nationalities are widely represented across the business:

Nationalities represented	**Total**
Board level	**7**
Global headquarters	**69**
Management level	**142**

Our approach to diversity is important to our reputation as a business, too. Societal and regulatory expectations are increasing – especially around gender diversity.

In 2013, the proportion of women in all management roles across the organisation was 32%. The table below sets out the gender breakdown within the British American Tobacco Group as at 31 December 2013, comparing numbers for all employees, our most senior managers and the Main Board:

	Total	Male	Female	% Male	% Female
Main Board	**11**	8	3	73%	27%
Senior Managers[*]	**244**	198	46	81%	19%
Total Group employees	**57,730**	43,875	13,855	76%	24%

[*] 'Senior Managers' are defined here as the members of the Management Board (excluding the Executive Directors) and the directors of the Group's principal subsidiary undertakings. The principal subsidiary undertakings, as set out in the Financial Statements, represented approximately 84% of the Group's employees and contributed over 80% of Group revenue and profit from operations as at 31 December 2013.

Our progress on diversity in 2013

We made good progress towards our diversity ambition in 2013. All of our leadership programmes now include diversity and we piloted a diversity workshop with our Management Board. This workshop is being rolled out across our leadership teams.

We agreed diversity plans with our companies, and all functions and regions now have diversity leads. We have set expectations with executive search firms to provide diverse candidate lists, and we have actively sought and hired senior talent from diversity segments to improve senior representation.

We have established a women's network in some of our markets, and in 2013 we also launched our Women in Leadership programme, which focuses on career progression coaching for high-potential female employees.

We lead our industry on corporate behaviour

We have clear policies that set the standard for the way we do business. They cover everything including employment, health and safety, environment, fighting child labour and tobacco trafficking. 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.

We engage openly on regulatory issues and supporting evidence-based regulation, and work with global partners to fight tobacco trafficking. We support sound regulation that:

- is consultative and shaped in collaboration with all stakeholders, including the tobacco industry;
- is based on robust evidence and thorough research; and
- delivers its policy aims and recognises unintended consequences.

Our approach to 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. Our approach draws on the UN Universal Declaration of Human Rights and the Organisation for Economic Co-operation and Development's (OECD's) Guidelines for Multinational Enterprises.

Human rights criteria are incorporated into our supply chain management programmes, in particular our SRTP programme. Our suppliers are required to meet criteria on issues including workers' rights and child labour, and we incorporate human rights criteria into our framework agreements with global suppliers. We also require compliance with Group policy and local laws from all of our companies.

We've always been industry leaders when it comes to addressing exploitative child labour and we're continually looking at new ways to help our suppliers prevent unethical work practices from taking hold. We were also founding members of the Eliminating Child Labour in Tobacco Growing (ECLT) Foundation.

We invest in the communities we work in

Our corporate social investment (CSI) activities include a range of community and charitable projects: providing people with 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 2013 was £8.7 million (2012: £11.5 million) as defined by the London Benchmarking Group's criteria for charitable donations.

We're committed to health and safety

We're a diverse company, operating across a huge range of different environments, from city offices to remote farms. Our goal of zero accidents reflects our commitment to providing a safe place to work for all employees and contractors. We achieved zero accidents at 72% of our reporting sites in 2013, up from 60% in 2012.

We achieved a 15% reduction in the number of injuries in our factory operations as a result of an ongoing focus on safer working conditions and behaviour. However, there was an 11% increase in the total number of reported injuries across the Group, as a result of employing a higher number of sales and distribution personnel who are out on the road and so are exposed to more risks.

Ongoing programmes to address the risks to our employees and contractors in the most challenging operating environments saw fatalities across our business reduced to six, from 12 in 2012. We deeply regret this loss of life and the suffering caused to friends, family and colleagues. We have carried out detailed reviews of each fatality to learn lessons and identify actions to prevent similar incidents.

Employee engagement

British American Tobacco is committed to employee engagement throughout the business. 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 open discussions. Global, regional and local intranets, web-based meetings and presentations also provide important information, while feedback is encouraged through open forums and Q&A sessions.

We carry out an employee opinion survey every two years to measure employee satisfaction and engagement. The latest survey, in 2012, was translated into 48 languages and completed by 42,932 employees. Our functions, regions and local companies around the world used feedback from the survey to address areas for improvement in 2013.

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 current employee engagement index score of 72% is ahead of the FMCG norm (68%).

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 Group companies.

Developing our organisation

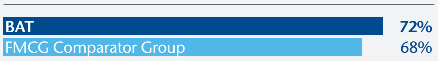
We believe that a key factor in embedding our Guiding Principles and fostering an inclusive culture will be driving ownership and accountability across the organisation. We want our people to act like owners in everything they do and take responsibility for their actions and for the future success of the business.

Managing diversity successfully means developing an inclusive environment, which values and harnesses the contributions of people with different backgrounds, experiences and perspectives. We are committed to providing our employees with a wide range of experiences and skills to develop to their full potential.

Business measures

Employee engagement index

72%



Definition: Results from our biennial 'Your Voice' employee opinion survey, last carried out in 2012, enable us to calculate our employee engagement index – a measure that reflects employee satisfaction, advocacy and pride in the organisation.

Objective: To achieve a more positive score than the norm for the fast moving consumer goods companies in our comparator benchmark group.

Delivering our strategy

Sustainability

Creating shared value is a priority for us. We do this by acting with integrity throughout our supply chain and wherever our products are sold, as well as through our investment in harm reduction.

What we do

Our commitment to sustainability underpins our strategy and our operations. Our priority continues to be working towards reducing the health risks posed by tobacco products and making available a range of less risky tobacco and nicotine-based alternatives. We work to ensure our supply chain is sustainable and we uphold the highest standards of corporate conduct and integrity in everything we do.

Creating shared value in 2013

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 focus on the material issues for our business

We decide which issues are most material, or most important to the business, by talking to our many different stakeholders, from shareholders and employees to consumers and suppliers.

The issues raised are then used to develop a list of the topics that are most important to our stakeholders and have the greatest potential to impact the business. They are grouped into three main areas:

- harm reduction (e-cigarettes, other nicotine inhalation devices, 'safer' cigarettes, heat-not-burn products, smokeless tobacco and our scientific research);
- sustainable agriculture (supporting farmers, environmental impacts, human rights, labour standards and child labour); and
- corporate behaviour (good corporate conduct, regulatory engagement, environment, health and safety, marketing practices, youth smoking prevention and tobacco trafficking).

We're serious about harm reduction

Scientists agree it's the toxicants in tobacco smoke that cause the overwhelming majority of smoking-related diseases, not the nicotine. So having a range of less risky nicotine-based alternatives for smokers can make a major contribution to public health.

We're recognised leaders when it comes to developing new products and in 2013 we became the first international tobacco company to launch an e-cigarette, Vype, in the UK. We are also at the forefront of developing a portfolio of less risky next-generation products, including new types of inhaled nicotine products and innovative heat-not-burn tobacco products.

We're working with scientists and regulators to promote this next generation of products and we would like to see tobacco harm reduction accepted as an important public heath objective.

We're investing in R&D

Our Group Research & Development (R&D) activities are focused on harm reduction, but they also develop new tobacco products and innovative technologies. They provide guidance on the use of ingredients, too, to ensure our products comply with all countries' legal requirements and our own Group standards.

In 2013 we invested £161 million in Group R&D (2012: £171m), including marketing innovations and the tests and trials to create a new generation of tobacco and nicotine products. Our principal R&D facilities are located in Southampton and Cambridge in the UK and at Cachoeirinha in Brazil.

Over the last five years we've published more than 100 peer reviewed research papers covering the science of harm reduction. We also contributed to over 28 leading scientific conferences, workshops and events in 2013, and have contributed extensively to the work of the US Food and Drug Administration on tobacco and nicotine product regulation. We also publish details of our scientific research programmes on our science website, www.bat-science.com.

We're addressing our environmental impacts

Reducing our environmental impacts is a key priority. We monitor and reduce our direct impacts by making our operations more efficient. We also seek to address our indirect impacts by choosing suppliers with strong environmental credentials and encouraging our existing suppliers to improve their environmental performance.

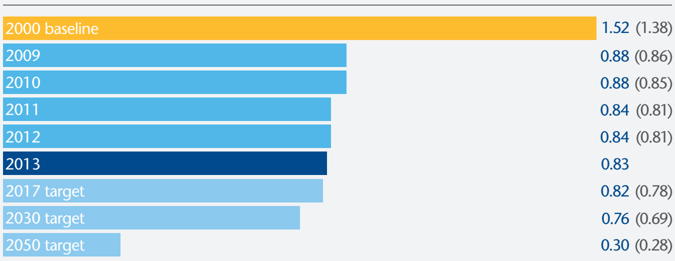
We put particular effort into minimising our energy consumption and reducing our carbon footprint, and we're proud that a number of our sites in the UK, Italy, Poland, Germany and the Netherlands, now meet 100% of their electricity needs from renewable sources.

Greenhouse gas emissions

Our long-term targets to cut gross carbon dioxide equivalent (CO_2e) emissions by 50% by 2030 and by 80% by 2050 from our year 2000 baseline are in line with UK Government targets and we have continued to make good progress. We also have a five-year milestone to reduce our gross CO_2e emissions by 46% by 2017.

In 2013, we reviewed our CO_2e emissions factors, in line with best practice and to meet new UK statutory reporting requirements on greenhouse gas (GHG) emissions. We also updated our 2000 baseline to take account of changes in reporting business travel.

Tonnes CO_2e per million cigarettes equivalent produced



Note:
To track performance consistently, our 2000 baseline, usage in previous years and our targets for 2017, 2030 and 2050 have been restated. Previously reported figures are provided in brackets.

We use the GHG Protocol Corporate Standard in defining our CO$_2$e reporting methodology, adopting an equity share approach to defining, consolidating and reporting our Scope 1 and Scope 2 CO$_2$e emissions.

Emissions	2012	**2013**
Scope 1 CO$_2$e emissions (tonnes)	362,779	**358,723**
Scope 2 CO$_2$e emissions (tonnes)	408,290	**389,242**
Scope 3 CO$_2$e emissions (tonnes)	209,332	**213,711**
Total (tonnes)	980,401	**961,677**
Intensity (per million cigarettes equivalent)	0.84	**0.83**

See www.bat.com/sustainability/data for further detail on our reporting scope and reporting rules.

We protect biodiversity

Since 2001, we have been working in the BAT Biodiversity Partnership with three major international conservation NGOs – Fauna & Flora International, the Earthwatch Institute and the Tropical Biology Association – to help protect the biodiversity in the landscapes where we work.

Together, we've developed a biodiversity risk and opportunity assessment (BROA), which we use to identify potential issues and impacts in tobacco farming landscapes, before working with other stakeholders to find solutions. The tool has been recognised by the UN Food and Agriculture Organization and the World Business Council for Sustainable Development as an approach that is comprehensive enough to be used by any organisation operating in an agricultural landscape.

We market our products responsibly

Our International Marketing Principles reflect current thinking in terms of marketing, technology, regulation and stakeholder expectations. They are standards that we place upon ourselves and often go far beyond what local laws require, especially around underage smoking.

We monitor compliance with our International Marketing Principles through market audits and annual self-assessments, and we are committed to 100% compliance across the Group.

Our marketing of Vype, our e-cigarette brand, is aimed at adult consumers of nicotine products only. All our e-cigarette packs, inserts and e-liquid refills have appropriate warnings, and are clearly labelled as being for those aged 18 or over.

A sustainable future

When we updated our Group strategy in 2013, we put a much greater emphasis on sustainability. It's about creating shared value and making sure that what we do benefits not only our shareholders but also a wide group of stakeholders.

We continue to tighten and refine our policies. In 2014 we will publish our revised Standards of Business Conduct that will include clearer statements on human rights and anti-child labour. We will also publish our consolidated policy on transparent lobbying on our website, www.bat.com.

Our transparent approach to scientific research will continue to help us develop new partnerships and collaborations between scientists and the tobacco industry. We hope this will lead to further breakthroughs in the science of tobacco harm reduction.

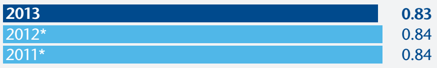
Business measures

Carbon dioxide equivalent (CO$_2$e) (tonnes CO$_2$e per million cigarettes equivalent produced)

0.83

45%

lower than 2000 baseline



Definition: We track Group CO$_2$e in tonnes per million cigarettes equivalent produced.

Target: To reduce Group CO$_2$e by 50% by 2030 from our restated 2000 baseline of 1.52 and by 80% by 2050.

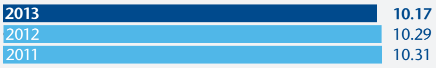
Note: *2011 and 2012 figures have been restated, as we reviewed our CO$_2$e emissions factors in 2013. We also updated our 2000 baseline.

Group energy use (gigajoules per million cigarettes equivalent produced)

10.17

14%

lower than 2007 baseline



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

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

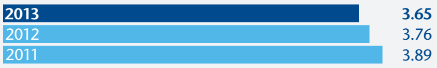
Note: Group energy use is the energy used by the Group in its own operations, business travel and freight. We do not include energy used to produce and deliver purchased energy.

Water use (cubic metres per million cigarettes equivalent produced)

3.65

25%

lower than 2007 baseline

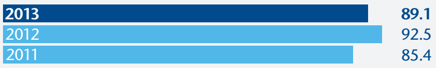


Definition: We track Group water use in cubic metres per million cigarettes equivalent produced.

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

Recycling (percentage of waste recycled)

89.1%



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

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

Key Group risk factors

Overview

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

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

The Group has identified, actively monitors and is taking action to mitigate many different risks. This section does not include them all, but focuses on those risks that the Directors believe to be the most important ones that 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 activities being undertaken to mitigate them should be considered in the context of the Group's internal control framework. This is described in the section on risk management and internal control in the corporate governance statement. This section should also be read in the context of the following cautionary statement.

Cautionary statement

The Strategic Report and certain other sections of this Annual Report 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.

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 regarding illicit trade, excise and tax and financial risk.

However, in the course of the year, the Board decided to increase its focus, as a key risk, of failing to lead the development of the non-tobacco nicotine market, in order to recognise the importance to the Group of its nicotine business, Nicoventures.

Regulatory risks facing the Group have been addressed in our risk register for a number of years, and reported as key risks previously. In previous years, sub-categories of risk relating to product ingredients regulation and advertising and packaging restrictions were presented separately to broader regulatory risk. This year's report presents regulation as a single risk, capturing its various elements, reflecting the Group's renewed focus on an integrated approach to its regulatory risk management programme.

Marketplace risk factors

Competition from illicit tobacco trade

Time frame
Long term

Strategic Impact
Growth (organic revenue growth)

Risk owner
Legal Director

Illicit trade in the form of counterfeit products, smuggled genuine products and locally manufactured products on which applicable taxes are evaded, represents a significant and growing threat to the legitimate tobacco industry. Most illicit products are sold at the bottom end of the market and in contravention of applicable regulatory requirements.

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

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

Principal causes

- 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.

Potential impact

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

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 range of AIT issues.
- Global AIT strategy supported by a research programme to further the understanding of the size and scope of the problem.
- AIT Intelligence Unit (including a dedicated analytical laboratory) works with enforcement agencies in pursuit of priority targets.
- Strong internal business conduct and customer approval policies.

Failure to lead developing non-tobacco nicotine market

Time frame
Long term

Strategic Impact
Growth (revenue growth) and
Sustainability (reduced-risk products)

Risk owner
Managing Director –
Next-Generation Products

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

Principal causes

- Draft EU Tobacco Products Directive limits the regulations associated with e-cigarettes and barriers to entry are low. Potential advertising restrictions, similar to tobacco, will impact brand building ability.
- In other markets, regulations limit the size of the potential market for reduced risk products by restricting channel access, marketing opportunities or by imposing excise levies.
- Inability to understand changes in consumer habits and preferences leading to lack of consumer-relevant product offerings.
- Inability to build consumer brands.
- Speed to market and speed of innovations is slower than competitors.
- Inadequate financial and human resources devoted to the Group's non-combustible business.
- Inability to manufacture and supply new non-combustible products in sufficient quantity.

Potential impact

- Consumer base, market share, profitability and achievement of growth targets will be undermined if competitors are more successful in establishing new categories or if advertising or access to all channels is restricted.
- While considered unlikely, alignment of non-combustible regulatory framework with traditional cigarettes would reduce business opportunities in the non-combustible category. Alignment of e-cigarettes to medicines would increase complexity and increase research and development costs, whilst reducing channel access.

Mitigation activities

- Nicoventures, a wholly-owned subsidiary, focuses exclusively on the development and commercialisation of innovative regulatory approved nicotine products that will enable the Group to offer a consumer-acceptable alternative to cigarettes with lower health risks.
- Appointment of Managing Director of Next-Generation Products and a strengthened senior management team for non-combustibles.
- Development of a full non-combustible strategy and business case.
- Market roll-out plans for licensed and unlicensed nicotine products.
- Vype launched in the UK, with further market launches planned.
- Constant M&A dialogue on potential non-combustible opportunities.

Key Group risk factors
continued

Excise and tax risk factors

Excise shocks from tax rate increases or structure changes

Time frame
Short term and long term

Strategic Impact
Growth (organic revenue growth)

Risk owner
Regional Directors

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

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

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.
- Requirements of the WHO's Framework Convention on Tobacco Control (FCTC), Article 6 (on Tobacco Taxation) to move to 70% excise tax and predominantly specific excise.

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 or portfolio erosion.

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 market levels.
- Engagement with local tax and customs authorities, where appropriate.
- Annual management review of brand portfolio, brand health and equity.
- Portfolio reviews incorporate potential impact of changes to excise rates and structures.
- Assessment of Article 6 impact for key markets undertaken and fed back to the regions and end markets.

Onerous disputed taxes, interest and penalties

Time frame
Short term

Strategic Impact
Productivity (capital effectiveness)

Risk owner
Finance Director

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

Principal causes

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

Potential impact

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

Mitigation activities

- 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.

Finance risk factors

Translational foreign exchange rate exposures

Time frame
Short term

Strategic Impact
Productivity (capital effectiveness)

Risk owner
Finance Director

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

Principal causes

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

Potential impact

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

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.

Access to end market cash resources

Time frame
Short term

Strategic Impact
Productivity (capital effectiveness)

Risk owner
Finance Director

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.

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.

Potential impact

- 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.
- Additional costs as a result of paying premiums to obtain hard currency.

Mitigation activities

- On-going monitoring of restricted 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.

Key Group risk factors
continued

Operations risk factors

Geopolitical tensions

Time frame
Long term

Strategic Impact
Growth (organic revenue growth)

Risk owner
Legal Director

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

Principal causes

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

Potential impact

- Potential loss of life, loss of assets and disruption to normal business processes.
- Increased costs due to more complex supply chain arrangements and/or the cost of building new facilities or maintaining inefficient facilities.
- Reduced volumes and impact on profits as a result of not being able to trade in a country.
- Reputational impact of inability to protect staff and assets from serious harm.

Mitigation activities

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

Risk of injury, illness or death in the workplace

Time frame
Short term

Strategic Impact
Sustainability

Risk owner
Operations Director

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.

Principal causes

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

Potential impact

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

Mitigation activities

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

Regulation risk factors

Tobacco regulation inhibits growth strategy

Time frame
Long term

Strategic Impact
Growth (organic revenue growth)
and Sustainability (balanced regulation)

Risk owner
CORA Director, Operations Director and Marketing Director

The enactment of regulation that places the Group at a competitive disadvantage, against both legal and illicit trade competitors, interferes with our ability to communicate with consumers, differentiate our products, launch future products, and increases our business costs and complexity.

Principal causes

- Pressure from international organisations, governments and the private sector to pursue 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 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.
- Adoption of the WHO's Framework Convention on Tobacco Control (FCTC) guidelines on packaging, labelling, advertising and promotion.
- Adoption of more stringent national regulations, such as point-of-sale display bans and plain packaging.

Potential impact

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

Mitigation activities

- A dedicated Regulatory Futures team working to manage our global approach to the Group's regulatory campaigns.
- Engagement coordinated and aligned across the Group to drive a balanced global policy framework for tobacco control.
- Prioritisation of key regulatory issues such as retail display bans, ingredients bans and pack space appropriation.
- Stakeholder mapping and prioritisation, developing robust advocacy materials, and regulatory engagement programmes.
- Regulatory risk assessment of marketing plans to ensure decisions are informed by an understanding of the potential regulatory environments.
- Development of an integrated regulatory strategy, balancing the commercial requirements of the combustible and non-combustible businesses.
- A 'Ready for Regulation' workstream helping to ensure that the business is ready for the effects of regulation and its impact on consumers.
- A research programme established in order to address regulatory compliance and farmer sustainability.

Regional Review
Overview

British American Tobacco performed well during the year with strong pricing and continued growth in Global Drive Brands. We met or exceeded all our long-term financial strategic objectives, on a constant currency basis. These excellent business results were, however, impacted by the weakness against sterling of some key currencies, notably the Brazilian real, South African rand, Japanese yen and Australian dollar. This was slightly offset by a stronger euro. The business performance was delivered against a backdrop of excise-driven price increases, industry contraction in some parts of the world and the fragile economic conditions in many countries.

Driven by a price-mix of 7%, revenue was up 4% at constant rates of exchange. At current rates, revenue was slightly higher.

Reported profit from operations was 3% higher at £5,526 million with a 3% increase in adjusted profit from operations, as explained on page 42. Adjusted profit from operations, at constant rates of exchange, grew by 7%.

Group cigarette volume from subsidiaries was 676 billion, down 2.7% from 694 billion in the previous year. Total tobacco volume was 2.6% lower. This was mainly the result of contracting industry volume in Western Europe and some key Group markets, such as Brazil, Russia, Ukraine, Turkey and South Africa, partially offset by strong performances in Bangladesh, Pakistan, Indonesia, Vietnam and the Middle East.

The Group's cigarette market share in its key markets was higher with growth of 20 basis points, while the share in the premium segment grew by an excellent 80 basis points.

Other tobacco products continued to perform well. Fine Cut volume in Western Europe grew by 1.3% to 21 billion sticks equivalent as a result of good growth in Italy, Belgium, Germany and Poland, partially offset by declines in the Netherlands and Greece.

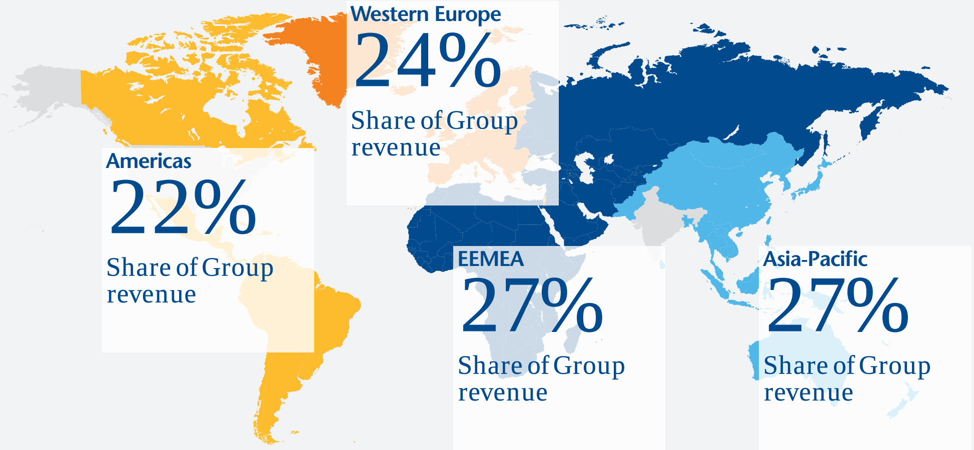
Our international brands grew by 2.1%, of which the four Global Drive Brands achieved good volume growth of 1.9%.

Dunhill increased volume by 9.7% with growth in Indonesia, South Korea and the GCC, partially offset by declines in Malaysia, due to market contraction, and West Africa. Kent volume was down 2.9% on last year as declines, driven by market contractions in Russia, Japan and Romania, were partially offset by growth in the Middle East and Uzbekistan.

Lucky Strike volume was down by 6.5%, mainly driven by the market contraction in Spain, partially offset by higher volume in the Philippines and Russia. Pall Mall volume rose by 4.4% with strong growth in Chile, Pakistan and Argentina, partially offset by lower volume in Russia, Serbia, Italy and Hungary.

Brands are reviewed from time to time to assess performance and increasing focus for investment. This review resulted in the decision to include Rothmans from 2014 as one of the Global Drive Brands. Rothmans performed well with strong growth in Russia, Ukraine, Algeria and Italy.

Our regional performance



Asia-Pacific

Volume (bn)
197
+5%
2012: 188

Revenue (£m)
4,203
0%
2012: 4,214

Adjusted profit (£m)
1,693
+2%
2012: 1,663

Share of Group revenue (%)
27
2012: 27

Americas

Volume (bn)
134
-6%
2012: 142

Revenue (£m)
3,317
-4%
2012: 3,460

Adjusted profit (£m)
1,364
-2%
2012: 1,391

Share of Group revenue (%)
22
2012: 23

Western Europe

Volume (bn)
119
-8%
2012: 129

Revenue (£m)
3,635
+6%
2012: 3,442

Adjusted profit (£m)
1,273
+8%
2012: 1,175

Share of Group revenue (%)
24
2012: 23

Eastern Europe, Middle East and Africa (EEMEA)

Volume (bn)
226
-4%
2012: 235

Revenue (£m)
4,105
+1%
2012: 4,074

Adjusted profit (£m)
1,490
+6%
2012: 1,412

Share of Group revenue (%)
27
2012: 27

Notes:

1. Adjusted profit from operations is derived after excluding the adjusting items from the profit from operations. These items include restructuring and integration costs, amortisation and impairment of trademarks and similar intangibles and a gain on deemed partial disposal of a trademark.
2. Constant currency provides the information based on a re-translation, at prior year exchange rates, of the current year information.

Regional Review
continued

Asia-Pacific

Share of Group revenue
27%
2012: 27%

Adjusted profit from operations (£m)
1,693
+2%
2012: 1,663

Adjusted profit was up £30 million to £1,693 million as a result of strong performances in Australia, New Zealand, Pakistan, Bangladesh and Taiwan, partially offset by South Korea and Japan, as well as continued investment in Indonesia and unfavourable exchange rate movements. At constant rates of exchange, profit would have increased by £124 million or 7%. Volume at 197 billion was 5% higher than last year, with increases in Pakistan, Bangladesh, Vietnam, Indonesia and the Philippines, partially offset by lower volumes in Japan and Malaysia.

Jack Bowles
Director, Asia-Pacific

"I am very pleased that Asia-Pacific achieved very strong results in 2013. We have a positive growth momentum, driven by excellent performance in key markets, successful brand building, and productivity savings. In 2014, we will continue to improve the execution of our strategy, invest in brand innovation and maintain our record of delivering cost savings. We have the right plans, proven capabilities and passionate people to succeed. I look forward to another year of good growth."

Australia

Profit was up strongly as a result of higher pricing and cost saving initiatives, partially offset by lower volume. Illicit trade increased following the introduction of plain packaging. Market share was lower.

New Zealand

Market share was higher, however, volume was impacted by the industry contraction. Profit grew strongly due to price increases and cost savings.

Japan

Despite significant competitor activity, there was good market share momentum exiting the year, driven by the introduction of innovations. Profit was adversely affected by a decrease in volume as a result of industry contraction, as well as exchange rate movements.

Malaysia

Market share grew strongly, driven by the excellent performance of Dunhill, strengthening the Group's leadership position. Profit was higher as the adverse impact of lower volume due to market contraction was offset by higher pricing.

Vietnam

The increase in volume and market share continued, driven by the strong performance of State Express 555. Profit increased as a result of growth in the premium segment, higher pricing and increased volume.

South Korea

Volume grew despite intense competitor activities resulting in market share slightly lower than last year. Dunhill held share and grew volume. Higher marketing investment, partially offset by cost savings, resulted in a decrease in profit.

Taiwan

Strong performances by Pall Mall and Lucky Strike contributed to a record high market share. An increase in volume, coupled with higher pricing, led to a strong increase in profit.

Pakistan

Impressive performances by Pall Mall and John Player Gold Leaf drove market share to a record high, strengthening the Group's leadership position. Profit increased significantly as a result of the higher volume, cost savings and increased pricing.

Bangladesh

An outstanding growth in profit was the result of a strong increase in market share and higher volume.

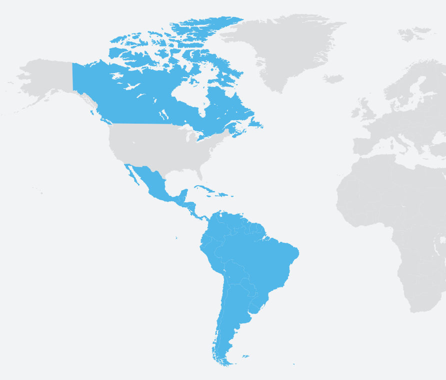
Indonesia

Significant increase in volume driven by Dunhill, the fastest growing brand in one of the largest tobacco markets in the world. Profitability was impacted by higher marketing investment, lower volume in low-priced brands and higher clove prices.

Philippines

As a result of the recent market entry following the removal of the discriminatory excise structure, Lucky Strike made good gains in volume and market share.

Americas



Share of Group revenue

22%

2012: 23%

Adjusted profit from operations (£m)

1,364

-2%

2012: 1,391

Ricardo Oberlander
Director, Americas

> "Despite tough conditions driven by market contraction and an increase in illicit trade, we delivered another year of strong results, strengthening our overall leadership position across the Americas. We successfully grew market share across the region, led by strong performances in Brazil, Mexico and the Caribbean & Central America. We delivered outstanding GDB volume growth. Challenges remain for 2014, but I am confident that we are well positioned to continue to win in the Americas."

Adjusted profit declined by £27 million to £1,364 million, mainly due to exchange rate movements in Brazil and Venezuela. At constant rates of exchange, profit rose by £62 million or 4%. Good performances from Brazil, Canada and Mexico were partially offset by adverse exchange rate movements and lower contributions from Chile and Colombia. Volume was down 6% at 134 billion, mainly as a result of market contractions in Brazil, Argentina and Chile, partially offset by increases in Mexico and Venezuela.

Brazil

Profit growth was driven by higher pricing and cost savings. This good result was more than offset by adverse exchange rate movements. Market share rose strongly but volume was down due to market contraction after significant excise increases and a subsequent rise in illicit trade.

Canada

Profit grew, benefiting from the stronger performance in the premium segment, price increases and a lower cost base. Volume and market share were lower.

Mexico

Impressive market share growth was led by the excellent performance of Pall Mall and the capsules innovation. A significant increase in profit was the result of higher volume and improved pricing, while illicit trade volume reduced.

Argentina

The strong performance of Lucky Strike led to a higher market share and also to an increased share of the premium segment. Profit was lower as a result of reduced volume and inflation-driven cost pressures which were not fully recovered through higher pricing.

Chile

Although Dunhill and Pall Mall performed very well, profit was lower, impacted by a decrease in volume, while market share was slightly down.

Venezuela

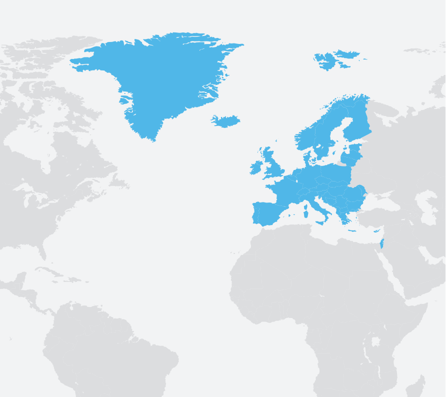
Market share was higher, boosted by Viceroy and Lucky Strike, and overall volume increased. Profit was significantly down, driven by the transactional impact of the currency devaluation.

Colombia

Volume grew, however, market share was slightly lower. Profit was adversely impacted by one-off costs.

Regional Review
continued

Western Europe



Share of Group revenue

24%

2012: 23%

Adjusted profit from operations (£m)

1,273

+8%

2012: 1,175

Naresh Sethi
Director,
Western Europe

> “European consumers remained under pressure in 2013. The industry has been affected by consumers looking for cheaper alternatives through down-trading and illicit trade. However, strong pricing, a focus on costs and continued investment have delivered strong profit and margin growth, ahead of industry trends. We also delivered share growth in our GDBs in both cigarettes and Fine Cut tobacco. In 2014 I believe we are set to deliver further growth through focused investment and innovation.”

Adjusted profit was up by £98 million to £1,273 million but at constant rates of exchange, the increase would have been £47 million or 4%. Industry volume declined sharply, affecting profit growth. There were strong profit performances in Germany, Switzerland, Belgium, Denmark, Sweden, the United Kingdom and Romania, partially offset by declines in Italy, the Netherlands and Spain. Cigarette volume was 8% lower at 119 billion, following market contractions in Italy, Spain, Poland, the Netherlands, Germany and France. Fine Cut volume at 21 billion sticks equivalent was up 1.3% as a result of increases in Italy, Germany, Poland and Belgium, partly offset by decreases in the Netherlands and Greece.

Italy

After its successful re-launch, Rothmans had good share growth and exited the year with continued momentum. Despite this, difficult trading conditions persist, which resulted in a profit decline. Share and volume in the Fine Cut segment grew.

Germany

Profit was up strongly. Cigarette volume was lower, in line with industry decline. Good share growth by Lucky Strike resulted in a stable overall market share. In the Fine Cut segment, share and volume grew due to the performance of Pall Mall.

France

Market share was stable with a good performance from Lucky Strike, although volume was lower, in line with the industry volume decline. Profit was stable, benefiting from exchange rate movements.

Switzerland

Profit grew as a result of higher pricing and lower costs, partially offset by volume and market share decline.

The Netherlands

Significant market contraction and declining market share resulted in lower volume, adversely impacting profit.

Belgium

Profit grew due to price increases, lower costs and strong growth in Fine Cut as a result of the good performance by Pall Mall. Cigarette volume and market share declined despite a strong growth by Lucky Strike.

Spain

Industry volume continued to fall sharply. Profit was adversely affected by volume decline and lower market share, partially offset by a lower cost base.

Romania

Excellent increase in market share was the result of the good performances of Dunhill and Pall Mall, although volume was lower. Profit was up, benefiting from price increases.

Poland

Decline in industry volume continued, adversely impacting volume and profit. Our market share was down, however, Lucky Strike performed well and Fine Cut volume grew.

United Kingdom

Good performances from Pall Mall and Rothmans led to increased market share although volume was lower. Profit grew strongly due to price increases, cost management and increased Fine Cut volume.

Denmark

Significant profit and volume growth was due to higher sales in December in anticipation of an excise duty increase in January 2014.

Eastern Europe, Middle East and Africa (EEMEA)

Share of Group revenue

27%

2012: 27%

Adjusted profit from operations (£m)

1,490

+6%

2012: 1,412

Andrew Gray
Director,
Eastern Europe,
Middle East and
Africa (EEMEA)

> "We performed well in 2013 despite political and economic instability in certain markets. We grew market share driven by strong performances in Russia, Ukraine, Kazakhstan and GCC. The successful launch of Rothmans in Russia and Ukraine was particularly rewarding. We have seen very good results in the Middle East and East Africa where volumes grew strongly. 2014 is set to be very competitive but we are well placed to deliver continued growth."

Adjusted profit increased by £78 million to £1,490 million. This was principally due to strong performances in Russia, the GCC and Ukraine and price increases, partially offset by a decrease in profit from Nigeria and the adverse impact of exchange rate movements. At constant rates of exchange, profit would have increased by £167 million or 12%. Volume at 226 billion was 4% lower than last year with the declines in Russia, Ukraine, Turkey, Egypt and South Africa, partially offset by an increase in the GCC.

Russia

Strong share growth driven by the impressive performance of Rothmans and the encouraging launch of Lucky Strike. Kent maintained its leadership position of the premium segment, contributing to the good profit growth. Volume was down.

Ukraine

A substantial profit increase was the result of pricing and an improved product mix, while strong market share growth was driven by excellent performances from Kent and Rothmans. Sharp industry volume decline and increased illicit trade led to lower volume.

Turkey

Continued volume decline adversely impacted profit and market share, despite growth by Viceroy and Kent.

The GCC

An impressive increase in profit was due to higher volume and price increases. The growth in market share was mainly due to the performance of Dunhill.

Egypt

Despite a good performance from Viceroy, market instability led to lower volume, adversely impacting profit.

Nigeria

Increased instability and competitor activities in the north and south-eastern parts of the country resulted in lower volume, adversely affecting profits.

South Africa

Profit grew as a result of price increases but this was more than offset by the adverse exchange rate movement. Volume was lower and market share was slightly down as a result of price competition.

Financial Review

The Group continued to perform strongly in a difficult environment

Revenue and profit from operations

The results of the Group were impacted by the adverse movement of a number of key currencies and this is reflected in an adverse translational exchange rate movement of around 4%. As a result, reported revenue was slightly up to £15,260 million and profit from operations was higher by 3% to £5,526 million.

To better understand the underlying performance of the business, management reviews the results by adjusting for a number of items relating to significant restructuring and integration costs and one-off charges, provisions and income. We call the underlying profit after adjusting for these items, which are described further below, adjusted profit from operations. Adjusted profit from operations was £5,820 million, up 3% from £5,641 million in 2012. In order to assess the underlying performance, we also have to view the business results at constant rates of exchange, excluding the translational impact of exchange rate movements. This does not adjust for the transactional effects of currency fluctuations.

The Group's strong underlying performance for the year is demonstrated by the growth of 4% in revenue and 7% in adjusted profit from operations, at constant rates of exchange.

The above non-GAAP measures are explained later in this review.

Organic growth

To achieve comparability, we use a measure, organic growth, whereby certain transactions that impacted only one year, or part of a year, are excluded from the results. However, there were no material items in 2012 or 2013 that led to organic growth being different from the reported growth.

Operating margin

The Group continues to improve its operating margin through strong pricing, tight cost control, factory rationalisation, the implementation of the new operating model, systems standardisation and productivity savings. In 2013, adjusted profit from operations, as a percentage of net revenue, improved to 38.1% compared to 37.1% in 2012. More details of the Group's adjusted operating performance can be found in the regional review.

Adjusting items

During 2013, 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 £246 million in 2013 mainly relate to the restructuring initiatives directly related to implementation of a new operating model, the continuation of factory closures in Australia and Russia, and restructurings in the Democratic Republic of the Congo, Switzerland and Germany, offset by profits on the sale of land and buildings in Australia, Russia and Denmark. The costs also cover separation packages in respect of permanent headcount reductions and permanent employee benefit reductions in the Group.

2013 Highlights

- Group revenue slightly up, impacted by exchange rate movements, but 4% higher at constant rates of exchange.
- Adjusted profit from operations at constant rates of exchange increased by 7%.
- Adjusted diluted earnings per share rose by 6% to 216.6p per share.
- At constant rates of exchange, adjusted diluted earnings per share were 10% higher at 224.7p.
- Dividends for 2013 up by 6% to 142.4p per share.
- Strong free cash flow of £3,371 million with free cash flow per share equal to 82% of adjusted diluted earnings per share.
- Share buy-back of £1.5 billion made in 2013, with £1.5 billion announced for 2014.

The £206 million restructuring and integration charge in 2012 principally related 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, it also includes separation packages in respect of permanent headcount reductions in the Group.

The acquisitions of Bentoel, Tekel, ST, Protabaco and CN Creative Limited, as well as the creation of CTBAT International Ltd, resulted in the capitalisation of trademarks and similar intangible assets, which are amortised over their expected useful lives, which do not exceed 20 years. The 2013 amortisation charge of £74 million, compared to £63 million in 2012, is treated as an adjusting item.

The contribution of the State Express 555 brand to CTBAT International Ltd is accounted for at fair value in the arrangement. This resulted in a £26 million gain on deemed partial disposal of a trademark, which has been treated as an adjusting item.

Net finance costs

Net finance costs at £466 million were £10 million higher than last year, reflecting the additional interest cost due on increased borrowings taken out by the Group.

Percentage increases in revenue and in profit from operations

	Revenue growth	Profit growth
As reported	0%	+3%
Adjusted		+3%
Adjusted at constant rates	+4%	+7%

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

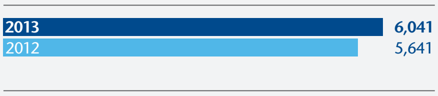
Revenue	2013					2012		
	Reported revenue £m	Impact of exchange £m	Revenue at CC[1] £m	Organic adjustments[2] £m	Organic revenue at CC[1] £m	Reported revenue £m	Organic adjustments[2] £m	Organic revenue £m
Asia-Pacific	**4,203**	**245**	**4,448**	**–**	**4,448**	4,214	–	4,214
Americas	**3,317**	**262**	**3,579**	**–**	**3,579**	3,460	–	3,460
Western Europe	**3,635**	**(142)**	**3,493**	**–**	**3,493**	3,442	–	3,442
EEMEA	**4,105**	**197**	**4,302**	**–**	**4,302**	4,074	–	4,074
Total	**15,260**	**562**	**15,822**	**–**	**15,822**	15,190	–	15,190

Profit from operations	2013							2012 Restated[4]		
	Profit[3] £m	Adjusting items £m	Adjusted profit[3] £m	Impact of exchange £m	Adjusted profit[3] at CC[1] £m	Organic adjustments[2] £m	Organic adjusted profit[3] at CC[1] £m	Adjusted profit[3] £m	Organic adjustments[2] £m	Organic adjusted profit[3] £m
Asia-Pacific	**1,672**	**21**	**1,693**	**94**	**1,787**	**–**	**1,787**	1,663	–	1,663
Americas	**1,303**	**61**	**1,364**	**89**	**1,453**	**–**	**1,453**	1,391	–	1,391
Western Europe	**1,133**	**140**	**1,273**	**(51)**	**1,222**	**–**	**1,222**	1,175	–	1,175
EEMEA	**1,418**	**72**	**1,490**	**89**	**1,579**	**–**	**1,579**	1,412	–	1,412
Total	**5,526**	**294**	**5,820**	**221**	**6,041**	**–**	**6,041**	5,641	–	5,641

Earnings per share	2013					2012 Restated[4]		
	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	**5,526**	**294**	**5,820**	**221**	**6,041**	5,372	269	5,641
Net finance costs	**(466)**	**–**	**(466)**	**2**	**(464)**	(456)	–	(456)
Associates and joint ventures	**739**	**(16)**	**723**	**15**	**738**	676	5	681
Profit before tax	**5,799**	**278**	**6,077**	**238**	**6,315**	5,592	274	5,866
Taxation	**(1,600)**	**(46)**	**(1,646)**	**(71)**	**(1,717)**	(1,516)	(70)	(1,586)
Non-controlling interest	**(295)**	**(3)**	**(298)**	**(13)**	**(311)**	(279)	(1)	(280)
Profit attributable to shareholders	**3,904**	**229**	**4,133**	**154**	**4,287**	3,797	203	4,000
Diluted number of shares	**1,908**		**1,908**		**1,908**	1,949		1,949
Diluted earnings per share (pence)	**204.6**		**216.6**		**224.7**	194.8		205.2

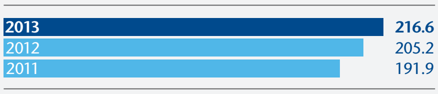
Notes
1. CC: constant currencies.
2. Organic adjustments: No organic adjustments were required for events in 2013.
3. PFO: Profit from operations.
4. The 2012 results have been restated for the adoption of the revised IAS 19 Employee Benefits (see page 43).

Adjusted profit from operations at constant rates
(£ million)



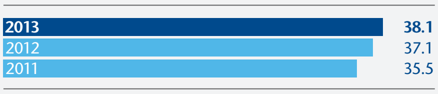
+7% 2013
+8% 2012
+10% 2011

Adjusted diluted EPS
(pence)



+6% 2013
+7% 2012
+11% 2011

Operating margin
(%)



+100bp 2013
+160bp 2012
+230bp 2011

Financial Review
continued

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 £63 million or 9% to £739 million.

In 2013, the Group's share of the adjusted post-tax results of associates increased by 6% to £723 million (2012: £681 million), or 8% at constant rates. The adjusting items for associates amounted to a net gain of £16 million (2012: £5 million expense).

The adjusted contribution from Reynolds American increased by 2% to £441 million. At constant rates of exchange the increase was 1%. The adjusted contribution from our associate in India, ITC, was £265 million, up 12%. At constant rates of exchange, the contribution would have been 21% higher than last year.

The adjusting items for associates are explained in note 5 of the financial statements.

Tax

Profit before tax was up £207 million at £5,799 million, reflecting the net impact of higher profit from operations, higher net finance costs and the increased contribution from associates.

The tax rates in the income statement of 27.6% in 2013 and 27.1% in 2012 are affected by the inclusion of the share of associates' post-tax profit in the Group's pre-tax results and by adjusting items. Excluding these, the underlying tax rate for subsidiaries was 30.7% in 2013 and 30.6% in 2012. The slight increase is the result of a change in the mix of profits.

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

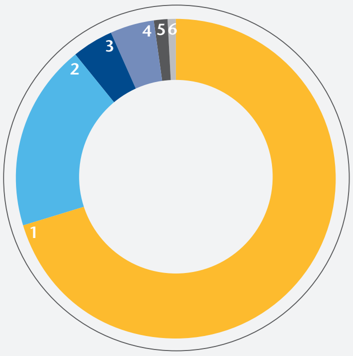
- comply with all applicable laws and regulations in the countries where we operate;
- be open and transparent with tax authorities and operate with mature, professional relationships;
- seek to optimise shareholder return by structuring the business in a tax efficient manner;
- transact on an arm's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

Our tax footprint extends beyond corporation tax and we are obliged to pay other significant taxes such as employment taxes and customs and import duties. Apart from the taxes borne, the Group also collects taxes on behalf of governments, such as tobacco excise, employee taxes, VAT and other sales taxes. The total tax contribution therefore consists of both taxes borne and taxes collected. In 2013, the total cash tax contribution by the Group amounted to £33.6 billion (2012: £33.1 billion), with the contribution by each category as shown in the chart below.

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

The corporate tax charge (current tax) for 2013 was £1.57 billion (2012: £1.54 billion), which differs from the tax paid of £1.44 billion (2012: £1.50 billion) due to the timing of corporation tax instalment payments which often straddle different financial years.

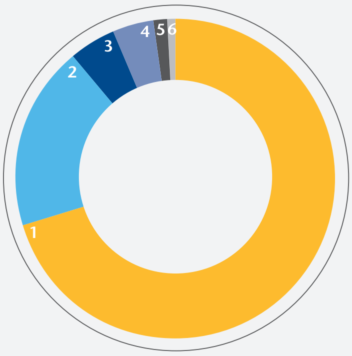
Major taxes borne and collected 2013
(£bn)



£33.6bn

1 Tobacco excise (collected)	23.7
2 Net VAT and other sales taxes (collected)	6.3
3 Corporation tax (borne)	1.4
4 Customs & Import duties (borne)	1.5
5 Taxes paid by employees (collected)	0.5
6 Employment taxes (borne)	0.2

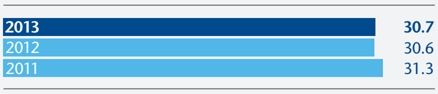
Major taxes borne and collected 2012
(£bn)



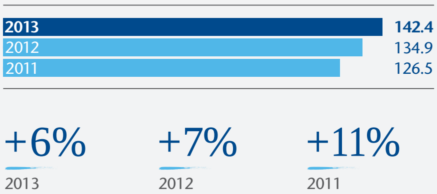
£33.1bn

1 Tobacco excise (collected)	23.3
2 Net VAT and other sales taxes (collected)	6.2
3 Corporation tax (borne)	1.5
4 Customs & Import duties (borne)	1.4
5 Taxes paid by employees (collected)	0.5
6 Employment taxes (borne)	0.2

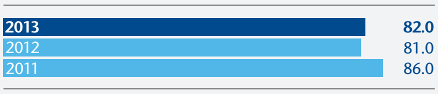
Underlying tax rate
(%)



Dividends per share declared
(pence)



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



Earnings per share

Basic earnings per share for 2013 were 205.4p, up 5% (2012: 195.8p). 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 on the financial statements.

On this basis, the adjusted diluted earnings per share were 216.6p, a 6% increase over 2012, mainly as a result of the strong operating performance, the increase in the share of post-tax results of associates and joint ventures and the impact of the share buy-back programme, partially 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 224.7p, a 10% increase on 2012.

Dividends

The Group's policy is to pay dividends of 65% of long-term sustainable earnings, calculated with reference to the adjusted diluted earnings per share. Interim dividends are calculated as one-third of the total dividends declared for the previous year. In 2013, as a result of the restatement of the 2012 numbers after a change in accounting policy (see below), the increase in dividends was kept at the same rate as the increase in earnings, leading to a dividend growth of 6% and a pay-out ratio of 65.7%.

With the recommended final dividend of 97.4p, the total dividends per share for 2013 are 142.4p, compared to the total dividend of 134.9p for 2012. Under IFRS, the recommended final dividend in respect of a year is only provided in the accounts of the following year. Therefore, the 2013 accounts reflect the 2012 final dividend and the 2013 interim dividend amounting to 137.7p (£2,611 million in total (2012: 130.6p – £2,538 million)). The table below shows the dividends declared in respect of 2013 and 2012.

Dividends are declared/proposed and payable in sterling except for those shareholders on the branch register in South Africa, whose dividends are payable in rand. A rate of exchange of £:R=17.89670 as at 25 February 2014, the closing rate for that day as quoted by Bloomberg, results in an equivalent final dividend of 1743.13858 SA cents per ordinary share. Further details of the final dividend and key dates (and the South Africa branch register key dates) are set out in the other statutory and regulatory information section.

Dividends declared/proposed

	2013		2012	
Ordinary shares	Pence per share	£m	Pence per share	£m
Interim	**45.0**	**846**	42.2	815
Final	**97.4**	**1,838**	92.7	1,765
	142.4	**2,684**	134.9	2,580

Treasury operations

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

The Board reviews and agrees the overall treasury policies and procedures, delegating appropriate oversight to the Finance Director and the Treasury function. The policies include a set of financing principles and key performance indicators.

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

The Group continues to maintain investment-grade credit ratings and was upgraded during 2013 by Moody's. As at 31 December 2013, the ratings from Moody's/S&P were A3 (stable outlook)/A- (stable outlook) (end 2012: Baa1/A-). 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.

Financial Review
continued

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 2013, the average centrally managed debt maturity was 7.2 years (2012: 7.2 years) and the highest proportion of centrally managed debt maturing in a single rolling 12-month period was 18.3% (2012: 19.3%).

The Group continues to have a £2 billion central banking facility with a final maturity date of December 2015. The facility is provided by 22 banks and was undrawn as at 31 December 2013 (31 December 2012: undrawn).

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 2013, £521 million of commercial paper was outstanding (31 December 2012: £nil).

In the year ended 31 December 2013, the Group continued with transactions in the capital markets.

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

In June 2012, the Group issued 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. Also in June 2012, the Group repaid a maturing €337 million bond and prepaid and cancelled a $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 €750 million bond with a maturity of January 2023.

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 2013 it is 12.3 times (2012 restated: 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.

Return on capital employed

The Group's return on capital employed improved from 29% in 2012 to 31% in 2013. This return is calculated as the adjusted profit from operations, divided by the average total assets net of average current liabilities.

Cash flow

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

Operating cash flow increased by £233 million, or 5%, to £5,320 million, reflecting the growth in underlying operating performance and the decrease in net capital expenditure, partially offset by working capital movements. The higher cash outflows in respect of the net movements relating to pension funds, net interest paid and higher dividends to non-controlling interests, were offset by lower taxation. The lower appropriations from associates was due to the Reynolds American share buy-back (£189 million in 2013 and £262 million in 2012). These, combined with the increase in restructuring costs, led to the Group's free cash flow increasing by £112 million or 3% to £3,371 million.

The ratio of free cash flow per share to adjusted diluted earnings per share was 82% (2012 restated: 81%).

Below free cash flow, the principal cash outflows for 2013 comprise the payment of the prior year final dividend and the 2013 interim dividend, which was £73 million higher at £2,611 million, as well as a £1,509 million outflow due to the continuation of the on-market share buy-back programme in 2013, up £251 million on 2012, including transaction costs.

During 2013, the cash outflow from net investing activities of £19 million relates mainly to the further payment on the purchase of CN Creative. In 2012, the cash outflow of £43 million relates mainly to the cash consideration paid on the purchase of CN Creative and for the acquisition of non-controlling interests in Bangladesh.

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 £847 million (2012: £637 million outflow). After taking account of other changes, especially exchange rate movements, total net debt was £1,042 million higher at £9,515 million at 31 December 2013 (2012: £8,473 million).

Cash flow and net debt movements

	2013 £m	2012 Restated* £m
Adjusted profit from operations	**5,820**	5,641
Depreciation, amortisation and impairment	**392**	385
Other non-cash items in operating profit	**30**	45
Profit from operations before depreciation and impairment	**6,242**	6,071
Increase in working capital	**(375)**	(242)
Net capital expenditure	**(547)**	(742)
Gross capital expenditure	**(720)**	(798)
Sale of fixed assets	**173**	56
Operating cash flow	**5,320**	5,087
Net of pension funds' shortfall funding and one-off receipts	**(190)**	(164)
Net interest paid	**(443)**	(429)
Tax paid	**(1,440)**	(1,496)
Dividends paid to non-controlling interests	**(265)**	(259)
Cash generated from operations	**2,982**	2,739
Restructuring costs	**(310)**	(228)
Dividends and other appropriations from associates	**699**	748
Free cash flow	**3,371**	3,259
Dividends paid to shareholders	**(2,611)**	(2,538)
Share buy-back (including transaction costs)	**(1,509)**	(1,258)
Net investment activities	**(19)**	(43)
Net flow from share schemes and other	**(79)**	(57)
Net cash outflow	**(847)**	(637)
External movements on net debt		
Exchange rate effects**	**(163)**	89
Change in accrued interest and other	**(32)**	3
Change in net debt	**(1,042)**	(545)
Opening net debt	**(8,473)**	(7,928)
Closing net debt	**(9,515)**	(8,473)

* 2012 numbers have been restated for the impact of the adoption of the revised IAS 19 Employee Benefits on the adjusted profit from operations and working capital movement.

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

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 £5,921 million (2012: £6,217 million), while unfunded scheme liabilities amounted to £337 million (2012: £378 million). The schemes' assets increased from £5,563 million in 2012 to £5,780 million in 2013.

After excluding unrecognised scheme surpluses of £19 million (2012: £15 million), the overall net liability for all pension and health care schemes in Group subsidiaries amounted to £497 million at the end of 2013, compared to £1,047 million at the end of 2012.

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.

Financial Review
continued

Changes in the Group

On 30 August 2013 the Group announced that CTBAT International Limited (CTBAT), a joint investment incorporated in Hong Kong between subsidiaries of China National Tobacco Corporation (CNTC) and British American Tobacco, had commenced official business operations. It owns and manages the worldwide international cigarette trademark State Express 555, and also owns the worldwide right outside China to the leading CNTC brand Shuang Xi. CTBAT is treated as a joint operation as defined under IFRS 11 Joint Arrangements, and operates as an extension of the existing tobacco businesses of its investors and the Group therefore recognises its share (50%) of the assets, liabilities, income and expenses of the arrangement on a line-by-line basis in the consolidated financial statements. CTBAT is reported as part of the Asia-Pacific Region with the majority of its international sales (non-China domestic sales) made through existing BAT end markets in that region.

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

On 18 December 2012, the Group acquired CN Creative, a UK-based company specialising in the development of e-cigarette technologies. The company's entire share capital was acquired from private investors for £40 million, payable at different stages of further product development. 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.

Share buy-back programme

The Board approved the continuation of the on-market share buy-back programme in 2013 with a value of up to £1.50 billion, excluding transaction costs. During 2013, 44 million shares were bought at a value of £1.50 billion, excluding transaction costs (2012: £1.25 billion). A continuation of the share buy-back to a value of £1.50 billion for 2014 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:

	2013 £m	2012 £m
Net debt due within one year		
Borrowings	**(1,980)**	(1,636)
Related derivatives	**55**	41
Cash and cash equivalents	**2,106**	2,081
Current available-for-sale investments	**54**	26
	235	512
Net debt due beyond one year		
Borrowings	**(9,716)**	(9,083)
Related derivatives	**(34)**	98
	(9,750)	(8,985)
Total net debt	**(9,515)**	(8,473)

Non-GAAP measures

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

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

Management reviews current and prior year segmental adjusted profit from operations of subsidiaries and joint operations and adjusted post-tax results of associates and joint ventures at constant rates of exchange. This allows comparison of the Group's results had they been translated at 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 JSE Limited (JSE) in South Africa, the Group is required to present headline earnings per share and headline diluted earnings per share.

Accounting policies

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

Accounting developments

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

With effect from 1 January 2013 the Group has adopted the revised IAS 19 Employee Benefits. The revised standard has not changed the values of retirement benefit assets and liabilities on the balance sheet, but has changed the amounts recognised in the income statement and in other comprehensive income. The expected return on plan assets and the interest cost on liabilities have been replaced by a new component of the income statement charge – interest on the net retirement benefit asset/liability. The revised standard has retrospective application and has reduced the profit for the year to 31 December 2012 by £46 million, with a compensating credit in other comprehensive income. The 2012 numbers have been restated accordingly.

Other changes to IFRS implemented in 2013, mainly affecting disclosures, are set out in the Notes on the Accounts (Note 1 – Accounting Policies).

Going concern

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

The key Group risk factors include analyses of financial risk and the Group's approach to financial risk management. Notes 21 and 24 in the notes on the accounts provide further detail on the Group's borrowings and management of financial risks.

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

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

Foreign currencies

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

	Average		Closing	
	2013	2012	**2013**	2012
US dollar	**1.564**	1.586	**1.656**	1.626
Canadian dollar	**1.612**	1.584	**1.760**	1.619
Euro	**1.178**	1.234	**1.202**	1.233
South African rand	**15.099**	13.054	**17.347**	13.791
Brazilian real	**3.381**	3.109	**3.908**	3.328
Australian dollar	**1.623**	1.532	**1.851**	1.566
Russian rouble	**49.853**	49.277	**54.424**	49.656
Japanese yen	**152.715**	126.633	**174.080**	140.549
Indian rupee	**91.707**	84.838	**102.447**	89.061

Ben Stevens
Finance Director and Chief Information Officer

Governance (Directors' Report)
Chairman's introduction

Dear Shareholder

This year the Board approved a re-articulation of our Group strategy, our vision and our mission. We re-emphasised the strategic pillars and guiding principles that will help the business achieve its aims. Articulating a clear strategy is an important part of the Board's role and a means by which we, the current leadership, can focus the efforts of the many people working in our organisation on creating a sustainable platform for future growth and continuing to deliver outstanding shareholder returns with the highest standards in corporate governance.

My aim is to support our executive management's agenda for delivering the strategy by ensuring the Board's effectiveness. The Board is collectively responsible for the long-term success of the Company and how it is directed and controlled, so our performance as a team, and our individual contribution, is thoroughly tested in our annual board evaluation. I am pleased to report that the input from our external facilitator of this year's exercise was positive. The detailed observations, and our 2014 action points, are set out in this section.

We are a diverse Board, in terms of both nationality and gender. Seven nationalities are represented on the Board and a quarter of our number are women. We believe we form a strong team, with a broad range of professional backgrounds and styles. Changes to the Board will continue to reflect the long-term demands of the business as we see it developing in the coming years.

As the shape of our Board and senior management structures should reflect our strategic direction, so too must our governance structures. This year we approved changes to our delegated authorities framework which, while ensuring that the Board retains appropriate oversight, will allow our fast developing non-combustibles business to be governed in parallel with, but separately from, our established tobacco business.

The Board has confidence that the Group's risk management and internal control processes strike the right balance between fostering entrepreneurship within our business model and safeguarding our shareholders' investment and the Company's assets.

Risk management links directly to strategy, and remains a significant part of the annual agenda of our Board, Audit and CSR committees, and our governance efforts across the Group. We report to you on our key Group risk factors up front in our Strategic Report on pages 24 to 29. The Audit Committee's report in this section gives you more detail on risk management and internal control and, as required under the latest UK Corporate Governance Code, sets out the significant issues the Committee considered in relation to our annual accounts.

The Remuneration Committee's report sees the most significant changes this year. Under new reporting requirements, we have set out our remuneration policy and provided single total figures for the pay and bonuses of each of our Executive Directors (including a full breakdown of how each element was determined).

At the end of this section, your Directors state their belief that this Annual Report, taken as a whole, presents a fair, balanced and understandable assessment of the Company and its prospects, and the key performance indicators that measure it. Before making this statement, we reconsidered and confirmed our confidence in the long-established processes that underpin its production and the advice of the Audit Committee which considered its accuracy, key messages, and tone.

Engaging with our shareholders is a chance to talk more about our assessment of the business, and to listen to their own views. I value the opportunity to discuss many aspects of corporate governance and strategy with our significant investors and analysts as part of our annual investor relations programme. I look forward to more meetings with you in the run-up to, and at, our 2014 AGM.

Richard Burrows
Chairman

Compliance statement

Throughout the year ended 31 December 2013 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 2012 (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 disclosures section.

Governance
Leadership and responsibilities

Governance framework

The Board

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

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 plans
- Reviewing risk management and internal control
- Reviewing Periodic Financial Reports
- Declaring interim/recommending final dividend

Board Committees

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

Audit Committee	CSR Committee	Nominations Committee	Remuneration Committee
+ See page 54	+ See page 58	+ See page 60	+ See page 61

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 2013.

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

Our 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 our Strategic Report on pages 12–13. The key activities of the Board in 2013, grouped under the Group's four strategy pillars, is set out in the accompanying table on pages 48–49. The Board's strategic priorities for 2014 are identified within the key performance indicators set out in our Strategic Report on page 14.

The Board devotes considerable attention to corporate governance matters relating to the Group's internal controls and compliance activities. It receives verbal updates from the chairmen of the Audit and CSR committees following each committee meeting, of which the Board receives full minutes (and the related papers are available to all Directors).

Management Board

The Management Board, chaired by the Chief Executive, is responsible for overseeing the implementation by the Group's tobacco 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 until 31 December 2013 the Chief Operating Officer, its other members comprise 11 senior Group executives.

Principal Management Board role

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

Next-Generation Products (NGP) Board

The NGP Board, chaired by the Chief Executive, is equivalent to the Management Board in seniority and responsibilities, but focuses exclusively on the Group's non-combustible business. Its other members are the Finance Director and Managing Director, NGP.

Principal NGP Board role

- Developing non-combustible strategy for approval by the Board
- Monitoring the overall performance of the NGP Group
- Making recommendations to the Board on NGP matters
- Overseeing the NGP Group's portfolio of programmes and projects
- Overseeing the management and development of talent within the NGP Group

Individual roles

Leadership

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

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

Separate and distinct roles

Oversight

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

Independent

Governance
Board of Directors

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1 Richard Burrows
Chairman (68)

Irish

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

Key appointments: NED and member of the Remuneration Committee of Rentokil Initial plc; a Supervisory Board Member, member of the Audit Committee and Chairman of the Remuneration Committee at Carlsberg A/S; NED of Eurasian Natural Resources Corporation PLC until 25 October 2013; and member of the Trilateral Commission.

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.

2 Christine Morin-Postel
Senior Independent Director (67)

French

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

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

Skills and experience: Chief Executive of Société Générale de Belgique, Executive Vice-President and member of the Executive Committee of Suez and Chairman and CEO of Crédisuez S.A.; studied political sciences and graduated from the Institut de Contrôle Gestion.

3 Nicandro Durante
Chief Executive (57)

Brazilian/Italian

Position: Chief Executive since March 2011.

Key appointments: Non-Executive Director and member of the Nomination Committee of Reckitt Benckiser Group plc.

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

4 Ben Stevens
Finance Director and Chief Information Officer (54)

British

Position: Finance Director since 2008; additionally Chief Information Officer since 2010.

Key appointments: No external appointments.

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

5 John Daly
Executive Director (57)

Irish

Position: Executive Director (formerly Chief Operating Officer since 2010, having stepped down from that role on 31 December 2013). Due to retire from the Board and the Company on 6 April 2014.

Key appointments: Non-Executive Director of Reynolds American Inc.

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.

6 Karen de Segundo
Non-Executive Director (67)

Dutch

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

Key appointments: NED and member of the Audit & Risk, Nomination, Remuneration and Safety & Sustainability Committees of Lonmin plc; Supervisory Board Member and member of the Finance & Investment and Nomination Committees at E.ON SE; and Member of the Board and member of the Audit Committee of Pöyry Oyj.

Skills and experience: 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.

7 Ann Godbehere
Non-Executive Director (58)

Canadian/British

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

Key appointments: NED, member of the Nominations Committee and Chair of the Audit Committee of Rio Tinto plc; 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.

Skills and experience: 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.


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8 Dr Gerard Murphy
Non-Executive Director (58)

Irish

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

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

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

9 Kieran Poynter
Non-Executive Director (63)

British

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

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

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

10 Anthony Ruys
Non-Executive Director (66)

Dutch

Position: Non-Executive Director since 2006; member of the Audit and Nominations Committees. Will retire at the conclusion of the 2014 AGM.

Key appointments: 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.

Skills and experience: 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.

11 Dr Richard Tubb
Non-Executive Director (54)

US

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

Key appointments: White House Physician Emeritus; member of the Board of Reference for Project Rescue and the Travel Medicine Advisory Board of Shoreland, Inc; advisory position at Lonsdale; and independent consultant for the Boston Consulting Group.

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

12 Savio Kwan
Non-Executive Director (65)

British

Position: Non-Executive Director since 6 January 2014; member of the Corporate Social Responsibility and Nominations Committees.

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

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

Attendance at Board meetings in 2013

Name	Attended/Eligible to attend
Richard Burrows	7/7
Christine Morin-Postel[1]	6/7
Nicandro Durante	7/7
Ben Stevens	7/7
John Daly	7/7
Karen de Segundo[1]	6/7
Ann Godbehere	7/7
Dr Gerry Murphy	7/7
Kieran Poynter[1]	6/7
Anthony Ruys	7/7
Dr Richard Tubb	7/7
Sir Nicholas Scheele[2]	2/2
Robert Lerwill[2]	2/2

Notes:

1. Christine Morin-Postel missed one scheduled meeting due to a family bereavement; Karen de Segundo missed the ad-hoc meeting in December; Kieran Poynter was unable to attend one scheduled meeting due to a long-standing prior engagement.
2. Sir Nicholas Scheele and Robert Lerwill retired as Non-Executive Directors at the AGM on 25 April 2013.

The Board held seven meetings in 2013. Six of these were scheduled. One meeting was held off-site over two days, and was devoted to strategy. Six Board meetings are scheduled for 2014.

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

Governance
Board of Directors continued

Strategic Board activities in 2013

Growth

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

Activities in 2013

- Reviewing and agreeing a re-articulation of the Group strategy;
- Satisfying itself through the year that management was on track to deliver the Group's strategy, and endorsing the direction and activities proposed by management to achieve its 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 vision, strategy and pipeline for non-combustible products in light of consumer research and the regulatory landscape;
- Keeping the Group's trading and performance under review, particularly the performance of the Group's key markets and its Global Drive Brands;
- Receiving updates on the Group's Chinese joint operation, which commenced operations in 2013, and market initiatives in Myanmar, the Philippines and Morocco;
- 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;
- Considering the potential impact on the business of specific risk factors in consultation with the Audit Committee (for example, this year the chairman of the Audit Committee updated the Board on its detailed review of the risk to the Group of restricted cash when operating in countries where access to foreign exchange is more limited); and
- Considering opportunities for growth through future strategic acquisitions, and scrutinising management's post-implementation review of the acquisition of Protabaco in Colombia in 2011.

Productivity

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

Activities in 2013

- Overseeing the rolling implementation of the Group's new Operating Model and Global IT solution, anticipated to significantly 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;
- Monitoring progress with the Group's Global Product Intelligence team and reviewing how technical resources have been allocated to support identified priority projects;
- Regularly reviewing the Group's liquidity, confirming that the Company was conforming with its financing principles, and noting planned refinancing activities for the year ahead. The Board also considered the Group's foreign exchange and counterparty exposures; and
- Considering a number of options and possible valuations of the Company's shares in order to assess the benefits of continuing the Group's share buy-back and to ensure that it would continue to be earnings accretive.

Delivering growth

In September, the Board held a two-day off-site meeting to approve the revised Group strategy.

The Board discussed new marketing insights and explored with the Marketing Director how these were informing brand development plans and driving the Group's innovation pipeline.

The Group's integrated product and leaf strategy was discussed in detail, as was our Product Strategy Pathway process and plans for securing sustainable sources of high-quality tobacco that are aligned to product portfolios.

The Finance Director also led a session on cost management initiatives, investment opportunities, and strategic drivers to enable collaborative and efficient ways of working.

+ **For more information on our Group Strategy**
see pages 10–11 of our Strategic Report

Sustainability

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

Activities in 2013

- Discussing the Group's science-based approach to harm reduction, the differing regulatory approaches to e-cigarette products, and receiving updates on the Group's activities to secure regulatory approvals for non-combustible pipeline products;
- Considering further development plans for the commercialisation of innovative, regulatory-approved nicotine products and analysis of the potential for the Group's pipeline products, including Vype, in a number of key markets;
- Approving a separate governance structure for the Group's non-combustibles business to enable more dedicated, flexible and reactive oversight in this fast-developing area of the business;
- Reviewing planned investor relations activities for the year ahead, including initiatives to improve targeting and engagement with the Group's principal shareholders;
- Reviewing the Group's regulatory strategy in the context of the current regulatory landscape, including plain packaging proposals outside Australia and, within the EU, the Tobacco Products Directive, and their potential implications for the business;
- Approving new terms of reference for the CSR Committee, allowing for more focused oversight of key sustainability issues and the integration of the Group's sustainability agenda within its operations; and
- Discussing external analysts perspectives of the Group, and of the sector, presented by one of our brokers.

Winning organisation

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

Activities in 2013

- Reviewing the development of the Group's Remuneration Policy to be presented to shareholders at the 2014 Annual General Meeting;
- Considering specific action plans and enablers to promote diversity within the Group in terms of representation of women and specific focus nationalities, and the Group's 2020 aspirational targets for the percentages of these employees in senior management roles;
- Reviewing the progress being made in developing the Group's People and Organisation strategy. In particular, the Board focused on improved recruitment, through the Group's e-recruitment website and social media activities, and tools to help performance and development;
- Reviewing the talent pipeline to the Management Board and confirming proposed appointments, in consultation with the Nominations Committee;
- Discussing the role of international assignments in career development plans for senior management;
- Reviewing detailed succession planning at Board level and Non-Executive Director appointments in light of medium and long-term strategic drivers, resulting in the appointment of Savio Kwan; and
- Discussing the results of the externally facilitated board evaluation exercise and action points arising.

Improving sustainability

On the second day of its strategy meeting, the Board looked at how specific elements of our new strategy were being brought to life and embedded within the organisation.

One of the Board's focus areas was our five commitments to society, centred around our efforts to deliver safer products, improve consumer information, support evidence-based regulation, maintain transparent business practices, and build stakeholder relationships.

The Board gave clear feedback and encouragement to Group management, stressing the Board's commitment to open and informed debate on harm reduction, and supporting initiatives that will enable the Group to deliver its sustainability programme.

Governance
Board effectiveness

Balance and diversity

A balanced Board

Our Non-Executive Directors come from broad industry and professional backgrounds, with varied experience and expertise aligned to the needs of our business. A quarter of our Board are women. 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.

Promoting diversity

The Board appreciates the benefit of diversity in all its forms, within its own membership and at all levels of the Group. The Board promotes diversity and is encouraging initiatives to improve gender diversity in senior management roles. You can read more about our diversity policy, including the proportion of women in our total workforce and in senior management, in the sustainability section of our Strategic Report on page 20.

Independence and conflicts of interest

Independence

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

Conflicts of interest

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

Each year, the Board considers afresh all previously authorised situational conflicts. Directors are excluded from the quorum and vote in respect of any matters in which they have an interest. No material conflicts were reported by Directors in 2013.

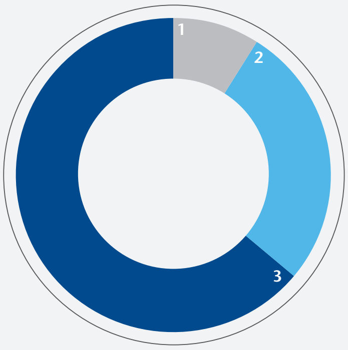
Information and professional development

Board induction

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

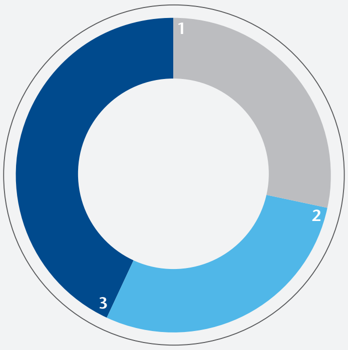
Following his appointment as a Non-Executive Director, Savio Kwan will be attending induction briefings covering the Group's strategy, organisational structure, business functions (including Next-Generation Products), statutory reporting cycle, financing principles, IT strategy and legal and regulatory issues. He will also attend sessions on corporate governance, internal control and risk management, and the role of the external auditors. He will visit one of the Group's factories, and has already visited our R&D facilities.

Balance of Non-Executive Directors and Executive Directors



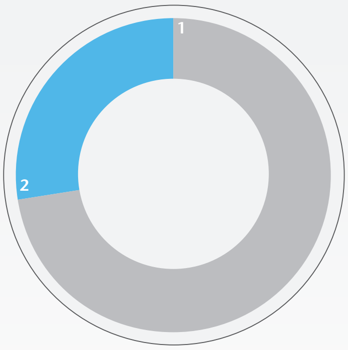
1 Chairman	1
2 Executive Directors	3
3 Independent Non-Executive Directors	7

Length of tenure of Non-Executive Directors



1 0-3 years	2
2 3-6 years	2
3 6-9 years	3

Gender split of Directors



1 Male	8
2 Female	3

Note:
The above graphics reflect the composition of the Board as at 31 December 2013 prior to the appointment of Savio Kwan in January 2014.

Training and development

Non-Executive Directors are encouraged to attend meetings of the Group's regional Audit and CSR committees, so that they have a good sense of the Group's regional operations. The Non-Executive Directors are also each invited to attend a scheduled market visit alongside a Regional Director, so that they gain exposure to the Group's business on the ground. In 2013, Non-Executive Directors visited Germany, Switzerland and Ukraine.

The Board and its Committees receive regular briefings on legal and regulatory developments. In 2013, these included updates on proposed regulations that could affect our industry around the world, including the EU Tobacco Products Directive. The Board was also briefed on the Narrative Reporting requirements, and the Remuneration Committee on the new regime for remuneration reporting.

The Chairman meets each Non-Executive Director individually in the latter part of each year to discuss their individual training and development plans. Fulfilling the Audit Committee's 2013 action points, its members received detailed technical training, details of which are set out in the Board evaluation summary in this section.

+ **For the Board's access to information and advice**
see 'Information and advice' in the other disclosures section on page 107

Shareholder engagement

Commitment to dialogue

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

The Remuneration Committee chairman has also led a significant shareholder engagement exercise on our remuneration policy, details of which can be found in the Remuneration report. He wrote to 39 institutions, 33 of which provided feedback on the policy, and he had follow-up meetings or calls with 19 of them.

Annual programme

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

Of these, over 420 meetings were held in 2013 with over 295 of the Company's institutional shareholders in 22 countries, spanning five continents. In terms of percentage shareholding, the Company spoke with the owners of the majority of its shares. The Chairman had nine personal meetings with major shareholders in the year. Regular investor presentations were also given, and these together with the results presentations are all published on www.bat.com. All results presentations are available to shareholders by webcast.

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

The AGM is an opportunity for further shareholder engagement and for the Chairman to explain the Company's progress and, along with other members of the Board, to answer any questions. All Directors attend, unless illness or pressing commitments prevents them. Details of our 2014 AGM are set out in the other disclosures section.

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

Topics of discussion

This year, shareholders were keen to hear more about our strategy for product innovation in our combustible and non-combustible businesses, and how innovation will drive future growth.

They were also interested to discuss the latest developments in industry regulation, including the impact that plain packaging has had in Australia, the potential impact of more plain packaging regulation worldwide and, in the EU, the Tobacco Products Directive.

Macro economic issues, specifically our exposure to weakness in the Eurozone and to currency headwinds, continues to be of key interest to institutional investors. At a market level, excise increases (and the related issue of increased illicit trade) were also regular topics.

Board evaluation

Evaluation process

The effectiveness of the Board and its Committees, the Executive and Non-Executive Directors, and the Chairman, were assessed in 2013 by an independent external facilitator, Dr Tracy Long of Boardroom Review Limited. The evaluation was conducted through in-depth interviews with each Board member and the facilitator's attendance at both a Board and CSR Committee meeting.

A report was prepared for the Board on the results of this exercise, and the principal Committees considered reports on their own effectiveness, drawn from the comments made in the Board report.

While the Board and each of its Committees are considered to be fully effective, fresh action points were identified. A summary of the findings is set out in the accompanying table. Our progress against 2012 action points is also included in the summary.

Constructive feedback

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

+ **For disclosures required by paragraph 7.2.6 of the Disclosure and Transparency Rules and the Companies Act 2006**
see the other disclosures section on pages 105–111

Governance
Board effectiveness continued

Board evaluation in 2013

Culture and dynamics

> “Board dynamics are good, with quality leadership, and no factions. We debate the issues against a solid background.”
>
> Non-Executive Director

Findings

- the Board has an open and transparent culture, encouraging active debate and a sophisticated level of challenge and enquiry;
- there is full cooperation between the Executive and Non-Executive Directors;
- there is no ‘group-think’ within the Board, and each director has a strong independent mindset;
- the Chairman is a good listener, managing the Board with an effective and consensual style;
- the CEO is a strong, performance orientated leader who knows the business well; and
- there is an even contribution by all Directors across the variety of topics discussed at Board meetings.

Action points for 2014

- Maintaining balance: recognising the strength of the Board’s culture and dynamics, the composition matrix considered by the Nominations Committee should factor in the balance of individual approaches and styles in addition to specific professional expertise.

Progress in 2013

- Director induction: following Dr Richard Tubb’s appointment to the Board in early 2013, he was appointed as a member of the CSR Committee and completed a full induction programme that included visits to the Group’s R&D facilities in Southampton and our factory in Bayreuth, Germany.

Composition and tenure

> “The strength of the executives’ knowledge, and the Board’s desire for debate, demand a high level of Non-Executive understanding and ability.”
>
> **Dr Tracy Long,** External Facilitator

Findings

- the composition of the Board, and its rolling tenure, combines a variety of professional experience;
- Board membership combines a diverse blend of intuitive and analytical perspectives;
- Non-Executive portfolio experience has been useful in improving internal processes (such as risk management); and
- as the business faces shifting consumer behaviour and changing trends, the Board would benefit from more experience of fast changing consumer landscapes and fast decision-making environments (which are often present in technology dependent, less regulated, industries).

Action points for 2014

- FMCG experience: experience in FMCG is likely to be a sector priority for the next round of Board appointees; and
- Non-financial expertise: as the Board is strong in financial expertise, it could accommodate more operational line management experience.

Progress in 2013

- Board and Committee balance and skills: the shortlisting and interviewing of candidates with technology-based skills and/or an Asian business background culminated in Savio Kwan’s appointment to the Board in January 2014. His background in the internet business, Alibaba.com, also provides welcome technical experience to the Board.

Strategy and operations

> “It’s an exciting new world, which has caught our imagination – as the Board, we need to understand the drivers.”
>
> Non-Executive Director

Findings

- the Board’s strategic debate is encouraged by the Chief Executive, and facilitated by the annual off-site meeting dedicated to strategy;
- the underlying performance of the business is closely scrutinised by executive management;
- the competitive, customer and regulatory landscapes are clearly visible to the Board, and a core part of the executive team’s regular updates;
- the Board receives high-quality consumer research;
- innovation and regulation are both recognised to be at the forefront of the Board’s agenda; and
- the Board is attuned to market sentiment and feedback from shareholder road-shows is valued.

Action points for 2014

- Stakeholder views: the CSR Committee will now incorporate an annual review of stakeholder maps into its agenda.

Progress in 2013

- CSR peer comparison: the CSR Committee reviewed how the Company compared to its industry peers in terms of delivery and reporting of its CSR agenda; and
- Shareholder engagement: the Chairman and the Chairman of the Remuneration Committee met together with institutions and key shareholders to discuss corporate governance and remuneration.

Risk and control

“Our regional Audit and CSR committees are where the rubber hits the road in terms of our internal controls. As Non-Executives, we see this first hand.”

Non-Executive Director

Findings

- all Directors commended the quality of financial information, noting that it was selective, current, reliable and well analysed;
- the approach and contribution of the FD, and his strong working relationship with the Audit Committee chairman were highlighted;
- the transparency of the regional and corporate audit programmes gave confidence to the Board;
- the relationship with the external auditors was described as both professional and challenging; and
- the high-level review of risks at Board level was facilitated by the comprehensive and open executive approach to risk, and the Group’s risk registers were commended as ‘living documents’.

Action points for 2014

- CSR coverage on market visits: in addition to gaining an overview of the Group’s in-country operations during market visits, additional focus on relevant CSR and sustainability issues will be incorporated into the agenda for each visit.

Progress in 2013

- Training: as part of its new annual training programme, the Audit Committee received a technical and governance briefing on topical issues including narrative reporting, updates to the UK Corporate Governance Code, and the latest views of the Competition Commission on audit tendering;
- Induction: the new Audit Committee chairman received an induction, which included meeting the external audit engagement partner and Head of Internal Audit; and
- Oversight: the Audit Committee received an in-depth global overview of internal audit ‘required actions’ and how these were tracked, including a focus on actions relevant to the roll-out of the Group’s revised Operating Model and single IT operating system.

Performance management

“People love to work for our company. There is loyalty and passion amongst senior and junior people, and a strong leadership development programme.”

Non-Executive Director

Findings

- the strong and positive corporate culture was nurtured by the Chief Executive;
- succession planning is seen as a particular strength, as is the leadership and development programme;
- there had been valuable consultation with institutional shareholders on remuneration matters;
- the Non-Executive Directors described the revised remuneration policies as sensible, disciplined and aligned; and
- the Board would need to retain its focus on how management would be promoting the Group’s diversity agenda.

Action points for 2014

- Diversity: following detailed presentations to the Board on executive diversity in 2013, the Board will continue to scrutinise plans to promote gender diversity in senior management roles and diversity in its broadest sense across the business.

Progress in 2013

- Remuneration policy: the Remuneration Committee conducted a full review of the Group’s remuneration policies and we have made a number of proposed changes to improve the alignment of Group KPIs to Group strategy, in consultation with shareholders.

Process and use of time

“The Board, as a whole, is not there to run the business, but when we meet we are 100% focused.”

Non-Executive Director

Findings

- the Board’s use of time was commended for the rhythm of meetings across the year and the use of Board dinners to continue strategic debate and succession planning in a less formal setting;
- the Board agenda allowed Directors to familiarise themselves with the Group and meet a variety of operational management during market visits;
- the healthy split of presentation and debate during Board meetings was felt to enable a tailored approach to the variety of topics on the agenda;
- the Board is well supported by the Company Secretarial team, which was acknowledged to be effective, experienced and trusted; and
- feedback on Directors’ market visits could be improved.

Action points for 2014

- Market visit feedback: as market visits have been redesigned to encourage small groups of Directors to visit a range of sites throughout the year, those Directors will now give a brief update to the Board on their observations following their visits.

Progress in 2013

- Chairman’s briefings: the Chairman now provides a regular update at Board meetings on his activities and meetings with investors and institutions;
- Board agenda: the Chairman and Company Secretary conducted a review of the frequency of meetings and regular agenda items; and
- Focus on sustainability: the CSR Committee refocused its forward agenda and terms of reference to reduce overlap with the work of the Audit Committee and devote more of its time to the Group’s core sustainability agenda (including youth smoking prevention, responsible tobacco marketing, diversity, human rights, health and safety, and sustainable agriculture and farmer livelihoods).

Governance
Audit and accountability

> “Our Audit Committee receives detailed reports and presentations throughout the year that enable it to monitor the integrity of our financial statements and our management of business risks.”

Audit Committee

Current members
Kieran Poynter (Chairman)
Ann Godbehere
Christine Morin-Postel
Anthony Ruys

Attendance at meetings in 2013

Name	Attended/Eligible to attend
Kieran Poynter	5/5
Ann Godbehere	5/5
Anthony Ruys[1]	5/5
Robert Lerwill[2]	2/2

Notes:
1. Anthony Ruys will cease to be a member upon his retirement as a Non-Executive Director at the AGM on 30 April 2014.
2. Robert Lerwill ceased to be a member upon his retirement as a Non-Executive Director at the AGM on 25 April 2013 (after which Kieran Poynter became Chairman of the Committee).
3. The Finance Director attends all meetings of the Committee but is not a member. Other Directors may attend by invitation. The Head of Audit and Business Risk, the General Counsel, and the external auditors, also attend meetings on a regular basis.
4. The Committee meets alone with the external auditors and, separately, the Group Head of Audit and Business Risk, at the end of every meeting.
5. The Committee held five meetings in 2013. All of these were scheduled.
6. Christine Morin-Postel became a member of the Committee on 6 January 2014, upon standing down from the CSR Committee.
7. Kieran Poynter and Ann Godbehere have recent and relevant financial experience.

Role

The Audit Committee monitors and reviews:

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

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

Key activities in 2013

Standing items of business considered by the Committee:

- the 2014 Internal Audit Plan;
- periodic reports from the Group’s regional Audit and CSR Committees and Corporate Audit Committee;
- 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;
- deep dives into specific risk topics (see further below);
- a report from the Head of Group Security on security risks and frauds and losses arising during the preceding year;
- quarterly reports on compliance with the Group’s Standards of Business Conduct;
- the Group’s 2012 results, 2013 half-year results, the external auditors’ reports for these, and interim management statements;
- the steps taken to validate the ‘Going Concern’ assessment at half-year and year-end (see ‘Going Concern’ in the Financial review);
- the results of the annual goodwill impairment assessment;
- an annual review of the external auditors’ independence; and
- a report from the Group Chief Accountant on the information flows, and drafting and approval processes for the preparation of the annual report, facilitating the Committee’s advice to the Board that the 2013 annual report is fair, balanced and understandable.

Further specific matters considered by the Committee:

- commissioning an external quality review of internal audit, which will be completed and reported on in 2014.

Risk topics considered by the Committee:

- IT functional readiness relating to the risk of the IT function not being fully enabled to support implementation, and sustain the integrity of, the Group’s single IT operating system;
- Foreign exchange and restricted cash which led to the significant accounting judgement described further below;
- contingency sourcing processes for the Group’s manufacturing operations; and
- changes to the status of risk management activities in a number of areas in the course of the year, and changes to the Group’s ‘top ten’ risks over the last three years, providing the Committee with a high-level view of the Group’s risk assessment processes and more focus on the Group’s non-combustible business.

Significant accounting judgements considered by the Committee in relation to the 2013 accounts:

- the continuing roll-out of the Group’s revised operating model and single IT operating system: Given the level of investment, complexity, and strategic importance to the Group, the Committee received updates from management, internal audit and the external auditors on progress with the roll-out throughout the year (including programme governance, risk and compliance activities). The Committee examined the proposed capitalisation of intangible assets (see Note 9 in the Notes on the accounts), amortisation of IT assets generated as part of the programme, and adjusting items in relation to implementation costs (see Note 3(e) in the Notes on the accounts), and was satisfied that the accounting treatment and disclosure of these matters was appropriate;

- the Group's significant corporate tax exposures, and related provisions: The Committee was updated periodically on corporate tax issues throughout the year. In December, the Committee considered a report from the Group Head of Tax on the current status of issues in various markets, including Brazil and Canada where potential tax disputes are more significant, and agreed with management's proposed provisions and extended disclosures in respect of them (see Note 30 in the Notes on the accounts);

- contingent liabilities in connection with on-going litigation: The Committee requested an update from management on recent developments in on-going cases (see Note 30 in the Notes on the accounts) and reassessed the need for provisions in respect of them. As it was too early to assess any impact the developments may have on the Group's potential liability, the Committee agreed with management that the current provision for the Fox River matter remained appropriate, and no provision should be recognised in respect of the Kalamazoo River matter; and

- foreign exchange and restricted cash: As the Group has operations in certain territories with severe currency restrictions, where foreign currency is not readily available, the Committee satisfied itself that the methodologies used to determine appropriate exchange rates for accounting purposes remained appropriate (for restricted cash, see the footnote to Note 19 in the Notes on the accounts).

External auditors

PricewaterhouseCoopers LLP has been the Company's auditors since it listed on the London Stock Exchange in September 1998. The Committee considers that the relationship with the auditors is working well and remains satisfied with their effectiveness.

As the Group implements its revised Operating Model and single IT operating system, consistency of approach in the audit was considered to be of particular importance. The Company will not, therefore, be putting its audit out to tender in 2014, but the Committee will review this position annually. There are no contractual obligations restricting the Company's choice of auditors.

The external auditors are required to rotate the audit partner responsible for the Group audit at least every five years, and those responsible for the subsidiary audits at least every seven years. The current lead audit partner has been in position for four years.

Auditor independence

The 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. 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.

The external auditors may not be engaged to provide services if the provision of such services would result in the external auditors:

- having a mutual or conflicting interest with any Group company;

- being placed in the position of auditing their own work;

- acting as a manager or employee of any Group company; or

- being placed in the position of advocate for any Group company.

Subject to the above, the external auditors may provide certain tax and other non-audit services. The Committee recognises that using the external auditors to provide such services is often of benefit due to their detailed knowledge of our business. Such services must be put to tender if expected spend exceeds specified limits, unless a waiver of this requirement is agreed by the Finance Director and notified to the Committee.

The policy also requires the submission to the 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 expected will be undertaken by the external auditors 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 Committee at the mid-year and year end. In this way, the 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 auditors' independence and objectivity.

A breakdown of audit, audit-related and non-audit fees paid to PricewaterhouseCoopers firms and associates in 2013 is provided in Note 3(d) in the Notes on the accounts and is summarised as follows:

Services provided by PricewaterhouseCoopers and associates

	2013 £m	2012 £m
Audit services	**9.4**	9.5
Audit-related assurance services	**0.3**	1.0
Total audit and audit-related services	**9.7**	10.5
Other assurance services	**0.1**	0.2
Tax advisory services	**2.9**	2.5
Tax compliance	**1.0**	0.9
Other non-audit services	**0.6**	0.5
Total non-audit services	**4.6**	4.1

Note:
In 2013 non-audit fees paid to PricewaterhouseCoopers amounted to 47% of the audit and audit-related assurance fees paid to them (2012: 39%).

Annual assessment

The 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. 94 surveys were completed this year and no material issues were identified. In addition, the Finance Director, Legal Director, Head of Internal Audit, Company Secretary and the Committee chairman all meet with the external auditors throughout the year to discuss relevant issues as well as the progress of the audit. Any significant issues are included on the Committee's agenda.

The Committee 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 or by other factors.

The Committee recognises that certain projects on which they are engaged necessarily span several years and that they will continue to provide those services for the length of the project. Projects linked to the Group's long-term IT strategy fall into this category.

Governance
Audit and accountability continued

Risk management and internal control

Overview

The Company maintains its system of risk management and internal control with a view to safeguarding shareholders' investment and the Company's assets. It is designed to identify, evaluate and manage risks that may impede the Company's objectives. It cannot, and is not designed to, eliminate them entirely. The system therefore provides a reasonable, not absolute, assurance against material misstatement or loss. A description of the key risk factors that may affect the Group's business is provided in our Strategic Report on pages 24–29.

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

Board oversight

The Board is responsible for determining the nature and extent of the significant risks that the Group is willing to take to achieve its strategic objectives and for maintaining sound risk management and internal control systems. With the support of the Audit Committee, it carries out a review of the effectiveness of the Group's risk management and internal control systems annually and reports to shareholders that it has done so.

This review covers all material controls including financial, operational and compliance controls and risk management systems. As part of its review in 2013, the Board noted that despite a number of changes to the Group Risk Register, which demonstrated its dynamic nature, the Group's risk profile remained stable.

Audit and CSR committee framework

The Group's Audit and CSR committee framework underpins the Board's Audit and CSR Committees. It provides a flexible channel for the structured flow of information through the Group, with committees covering locally listed Group entities in certain markets, and covering the Group's regions, each referring matters to the next level as appropriate. This framework ensures that significant financial, social, environmental and reputational risks faced by the Company and its subsidiaries are appropriately managed and that any failings or weaknesses are identified so that remedial action may be taken.

The Group's regional audit and CSR committees (which are all chaired by an Executive Director and attended by one or more Non-Executive Directors) focus on risks and the control environment within each region and are in turn supported by area and/or local audit and CSR committees. The Corporate Audit Committee focuses on the Group's risks and control environment that falls outside the regional committees' remit, for example head office central functions, global programmes and projects. It comprises members of the Management Board, is chaired by a Regional Director, and is attended by one or more Non-Executive Directors.

External and internal auditors attend meetings of these committees and have private audiences with members of the committees after every meeting. Additionally, central, regional and individual market management, along with internal audit, supports the Board in its role of ensuring a sound control environment.

Risk management

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

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

+ **For more information on risk factors see**
the Key Group risk factors section in our Strategic Report on pages 24–29

Internal control

Group companies and other business units are required annually to complete a checklist, called Control Navigator, of the key controls that they are expected to have in place. Its purpose is to enable them to self-assess their internal control environment, assist them in identifying any controls 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.

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 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 in order to prepare 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. The heads of finance responsible for the Group's markets and all senior managers must also confirm annually that all information relevant to the Group audit has been provided to the Directors and that reasonable steps have been taken to ensure full disclosure in response to requests for information from the external auditors.

The effectiveness of the Group's financial reporting controls are assessed as part of the Control Navigator exercise described above and evaluated by internal audit in the context of the annual audit plan. The integrity of the Group's public financial reporting is further supported by a number of processes and steps to provide assurance of 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 Committee, and review and approval by the Board.

Standards of Business Conduct

The Committee is responsible for monitoring compliance with the Company's Standards of Business Conduct (the 'Standards'), which underpin the Group's commitment to good corporate behaviour. The Standards require all staff to act with high standards of business integrity, comply with applicable laws and regulations, and ensure that standards are never compromised for the sake of results.

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

Information on compliance with the Standards is gathered at a regional and global level and reported to the regional audit and CSR committees and to the Committee.

The Standards, and information on the total number of incidents reported under them in 2013 (including established breaches), is available at www.bat.com/governance. The number of incidents is reviewed by Ernst & Young LLP as part of their process for providing assurance of our annual Sustainability Report. Their full assurance statement is available at www.bat.com/assurance.

In 2013, 22 instances of suspected improper conduct contrary to the Standards (excluding non-material employee fraud and theft against Group companies) were reported to the Committee (2012: 45).

Nine were established as breaches and appropriate action taken (2012: 16). In 10 cases, an investigation found no wrongdoing (2012: 24). In three cases, the investigation continued at the year-end (2012: five). No instances involved sums or matters considered material to the Group.

Whistleblowing

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

Of the total number of business conduct incidents reported in 2013, set out above, 18 were brought to management's attention through whistleblowing reports from employees, ex-employees, third parties or unknown individuals reporting anonymously (2012: 39).

Political contributions

The Committee is responsible for reviewing donations made for political purposes throughout the Group. No political donations were made in 2013 in any part of the world (2012: £5,583).

Annual review

The Turnbull Guidance (the 'Guidance') sets out best practice on internal control for UK-listed companies to assist them in assessing the application of the Code's Principles and compliance with the Code's Provisions with regard to risk management and internal control. The processes described above, and the reports that they give rise to, enable the Board and the Committee to monitor the risk management and internal control framework on a continuing basis throughout the year and to review its effectiveness at the year-end. The Board, with advice from the Committee, has completed its annual review of the effectiveness of the system of risk management and internal control for 2013.

No significant failings or weaknesses were identified and the Board is satisfied that, where areas for improvement were identified, processes are in place to ensure that remedial action is taken and progress is monitored. The Board is satisfied that the system of risk management and internal control accords with the Guidance.

Governance
Corporate social responsibility

> "The CSR Committee ensures that our sustainability programme is on track, and that we take advantage of the many opportunities that sustainability brings to the business, society and our stakeholders."

CSR Committee

Current members
Karen de Segundo (Chairman)
Dr Richard Tubb
Savio Kwan

Attendance at meetings in 2013

Name	Attended/Eligible to attend
Karen de Segundo	5/5
Christine Morin-Postel[1]	4/5
Dr Richard Tubb	5/5
Sir Nicholas Scheele[2]	2/2

Notes:

1. Christine Morin-Postel was unable to attend one of the scheduled meetings due to a family bereavement. She stood down from the Committee on 6 January 2014 to become a member of the Audit Committee.
2. Sir Nicholas Scheele ceased to be a member upon his retirement as a Non-Executive Director at the 2013 AGM.
3. 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.
4. The Committee held five meetings in 2013. All of these were scheduled.
5. Savio Kwan became a member of the Committee following his appointment as a Non-Executive Director on 6 January 2014.

Role

The CSR Committee monitors and reviews:

- the Company's management of CSR and the conduct of business in accordance with our Statement of Business Principles, making appropriate recommendations to the Board on CSR matters;
- the effectiveness of the Group's strategy for, and management of, significant social, environmental and reputational issues;
- the Group's sustainability plans and activities; and
- the effectiveness of CSR governance including, on an exceptional basis, reports from the regional audit and CSR committees.

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

Key activities in 2013

CSR governance and compliance

- considering feedback from the regional audit and CSR committees and considering CSR-related internal audit reports and recommendations, including in relation to the Group's approach to environmental, health and safety issues;
- reviewing the potential reputational impact arising from incidents of non-compliance with the Standards of Business Conduct;
- monitoring adherence to the Group's International Marketing Principles (IMP);
- considering Group risks in the countries that are of potential concern from a human rights perspective, and reviewing the measures and controls in place to mitigate those risks;
- reviewing the Group's environmental, health and safety (EHS) strategy, measures, targets and performance data;
- reviewing the progress of the Group's sustainable leaf strategy, aimed at building long-term partnerships with farmers based upon economic viability, and environmental and social initiatives;
- reviewing the Group's youth smoking prevention (YSP) activities, and analysis of their global reach and impact;
- reviewing the Group's corporate social investment strategy, plans and activities; and
- considering proposed amendments to the Committee's terms of reference and forward agenda to enable more in-depth oversight of core sustainability principles and how they are embedded within the Group.

Sustainability planning and reporting

- reviewing central and local stakeholder dialogue activities in 2013 and planned dialogue activities for 2014;
- reviewing the 2012 Sustainability Summary and two 2013 Focus Reports on harm reduction and corporate integrity, including summaries of external feedback and endorsements, and Ernst & Young LLP's assurance statements in respect of each;
- considering a review of the Company's delivery and reporting of its CSR agenda compared to industry and other FMCG peers;
- assessing progress against the Group's sustainability goals and commitments;
- considering the Group's 2014 sustainability reporting plans; and
- re-engaging 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.

Our 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, 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.

+ **For information on our greenhouse gas emissions see**
the sustainability section of our Strategic Report on pages 22–23

Statement of Business Principles

The Group's Statement of Business Principles sets out the expectations for responsible management of the Group's business. It was developed in 2002 in consultation with stakeholders, supported by the Institute of Business Ethics.

The Statement comprises three principles – Mutual Benefit, Responsible Product Stewardship and Good Corporate Conduct – and 18 Core Beliefs explaining each principle in more detail.

+ **To view our Statement of Business Principles visit**
www.bat.com/governance

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. In 2014, we plan to review our Standards of Business Conduct to incorporate additional provisions on human rights.

+ **For information on our approach to human rights see**
the sustainability section of our Strategic Report on page 21

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 a means of maintaining good relationships with local communities, rather than as a means of promotion.

Guidance on selecting, managing and evaluating major CSI activities is provided to Group companies. However, it is recognised that local community needs are diverse. As a result, within the parameters of this guidance and guidelines on focus of spend, CSI is managed locally to ensure the most appropriate projects are supported.

At Group level, the major activities supported by the Company are the British American Tobacco Biodiversity Partnership and the Eliminating Child Labour in Tobacco Growing Foundation.

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 rigorous approach has been applied to reporting processes at both Group and local level. This includes following the AA1000 Assurance Standard and Global Reporting Initiative (GRI) guidelines and obtaining independent assurance of all reports and engaging with stakeholders through independently facilitated dialogue sessions.

This approach has allowed the Company to meet greater demands for corporate transparency. Dialogue has also 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 Committee approved the Sustainability Summary, published alongside the 2012 Annual Report, covering the Company's performance and key issues for the business and stakeholders. It addition, it approved the publication of two focus reports, on harm reduction and corporate integrity, providing stakeholders with in-depth information on these topics.

+ **To view our Sustainability Summary and Focus Reports visit**
www.bat.com/sustainability

External recognition

In 2013, British American Tobacco was included in both the Dow Jones Sustainability World and Europe Indices for the 12th year running. The Indexes track the economic, environmental and social performance of leading sustainability-driven companies worldwide. The Company's overall score was 87%, maintaining our place as industry leader.

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.

For the second consecutive year, we 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'.

We were also listed as a component of the STOXX Global ESG Leaders indices, an innovative series of environmental, social and governance (ESG) equity indices owned by Deutsche Börse (the German Stock Exchange). This index model allows investors to understand which factors determine a company's ESG rating and why these factors are important.

We were recognised by Ernst & Young South Africa for the quality of our integrated reporting, following their assessment of the annual reports and sustainability reports of companies with a listing on the Johannesburg Stock Exchange against guidelines published by the International Integrated Reporting Council.

Governance
Appointments to the Board

> "We continue to ensure the balance of skills and experience on the Board is aligned to our Group strategy and creates a strong leadership team for the business."

Nominations Committee

Current members
Richard Burrows (Chairman)
Christine Morin-Postel
Karen de Segundo
Ann Godbehere
Dr Gerry Murphy
Kieran Poynter
Anthony Ruys
Dr Richard Tubb
Savio Kwan

Attendance at meetings in 2013

Name	Attended/Eligible to attend
Richard Burrows	4/4
Karen de Segundo[1]	3/4
Ann Godbehere	4/4
Christine Morin-Postel[1]	3/4
Dr Gerry Murphy	4/4
Kieran Poynter	4/4
Anthony Ruys	4/4
Dr Richard Tubb	4/4
Sir Nicholas Scheele[2]	2/2
Robert Lerwill[2]	2/2

Notes:
1. Karen de Segundo was unable to attend one meeting, as it was ad-hoc and organised on short notice (see note 4). Christine Morin-Postel was unable to attend one of the scheduled meetings due to a family bereavement.
2. Sir Nicholas Scheele and Robert Lerwill ceased to be members upon their retirement as Non-Executive Directors at the AGM on 25 April 2013.
3. The Chief Executive and Group Human Resources Director regularly attend meetings by invitation but are not members.
4. The Committee held four meetings in 2013, three of which were scheduled and one of which was convened at short notice to consider a Board appointment.
5. Savio Kwan became a member on his appointment to the Board in January 2014.

Role

The Nominations Committee is responsible for:

- reviewing the structure, size and composition of the Board and Management Board to ensure both have an appropriate balance of skills, expertise, knowledge and (for the Board) independence;
- reviewing the succession plans for the Executive Directors and members of the Management Board;
- ensuring that the procedure for appointing Directors is rigorous, transparent, objective, merit-based and has regard for diversity;
- making recommendations to the Board on suitable candidates for appointments to the Board and Management Board; and
- assessing the time needed to fulfil the roles of Chairman, Senior Independent Director and Non-Executive Director, and ensuring Non-Executive Directors have sufficient time to fulfil their duties.

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

Key activities in 2013

- reviewing succession planning for the Executive Directors and for the Management Board;
- reviewing the creation of bespoke Development Plans for high potential candidates for Executive Director and Management Board roles (covering the key experience required for further progression, mentoring, and education opportunities);
- considering the retirement of John Daly from the role of COO on 31 December 2013, and his resignation from the Board of the Company on 6 April 2014. The Committee agreed, based upon its review of succession planning, that it would not appoint a replacement COO at this stage and recommended to the Board that the Group's current Regional Directors and Operations Director report directly to the CEO; and
- the recruitment of Savio Kwan as a Non-Executive Director.

Terms of appointment to the Board

The Executive Directors have rolling contracts of one year. 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 on pages 76–79.

The Non-Executive Directors do not have service contracts with the Company but instead have letters of appointment for one year only, which include their expected time commitment of 25–30 days per year, and which are considered for renewal around the time of the Company's AGM when each Director is subject to election or re-election by the shareholders (see below). The Board takes into account the need for it to refresh its membership progressively over time. Non-Executive Directors are normally expected to serve for six years. They may be invited to serve for longer, but additional service beyond six years is subject to rigorous review, and service beyond nine years is unlikely.

The Committee is responsible for identifying candidates for positions on the Board. This process includes an evaluation of the skills and experience to be looked for in candidates to ensure continuing Board balance and relevant experience. The selection process will generally involve interviews with several candidates, using the services of specialist external search firms to identify and shortlist appropriate candidates. A balanced list including both genders is a requirement of any shortlist. This process was followed for the recruitment of Savio Kwan, who was shortlisted by an independent external consultancy, Odgers Berndtson, and interviewed by the Chairman, Executive Directors, and members of the Committee, which then recommended his appointment to the Board.

Annual General Meeting 2014

At this year's AGM on 30 April 2014, the Company will be submitting all eligible Directors for re-election (all Directors, with the exception of Anthony Ruys) and, in the case of Savio Kwan, election for the first time. Anthony Ruys, having served on the Board for eight years, will retire at the conclusion of the 2014 AGM.

The Chairman's letter accompanying the AGM Notice 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 are also provided.

Remuneration Report
Annual Statement

> "We have listened carefully to the points raised by shareholders and we believe that we have achieved a fair balance to reward Executive Directors for delivering sustainable value."
>
> **Dr Gerry Murphy**
> Chairman, Remuneration Committee

Dear Shareholder,

This Report is the first in the new format following the introduction of new UK Government regulations in respect of remuneration disclosures. It is split into two distinct sections: a policy report which looks forward to the Group's proposals for remuneration for the next three years and an annual report on remuneration, which sets out the work of the Committee in 2013 and the payments and awards made to Executive Directors during the year. Together, they provide a comprehensive picture as to how the Committee seeks to link executive remuneration with the Company's strategy and performance.

As many of you will know, the Committee completed a comprehensive review of executive remuneration during the year. We came to the conclusion that the broad structure of our existing remuneration arrangements continues to serve shareholders well and rewards management appropriately. Consequently, the changes we have introduced are focused and limited, remaining faithful to our established principles of simplicity and transparency while at the same time ensuring closer alignment with the Company's strategy and long-term shareholder interests.

The principal changes are:

- The introduction of an individual performance adjustment factor in the annual International Executive Incentive Scheme (IEIS) to reward outstanding (or penalise poor) performance of the senior management population, including the Executive Directors. This adjustment factor can, where applied, adjust the award outcome for an individual executive upwards by either 10% or 20% or downwards by 50% in relation to the corporate result. However, with regard to its application to any Executive Director, any upward adjustment will operate within the current scheme maximum award levels, i.e. 200% for the Chief Executive and 180% for the other Executive Directors. The new individual performance element is being introduced for all of British American Tobacco's 220 senior managers (for performance in 2014, recognised in 2015) and the assessment of an individual's performance will be based on an established and robust annual appraisal methodology.

- The introduction of net turnover (NTO) as a metric in our long-term incentive scheme (LTIP). Under this metric, 25% of LTIP share awards will vest for compound annual growth in organic sales over a three-year period of between 2% (6% vesting) and 5% (25% vesting).

- The reduction of the TSR component in the LTIP. The TSR-dependent weighting of the LTIP drops from 50% to 25%, focusing solely on the more relevant global consumer companies' (FMCG) comparator group. No change in vesting conditions is proposed under this metric.

- Earnings per share (EPS). This retains its 50% weighting but moves to an absolute growth range of 5–10% vs. the current range of UK RPI + 3 to 8% since UK inflation has minimal relevance to our global operations.

I wrote to around 40 of our major shareholders outlining these proposals, offering to meet to discuss them in person. As a result, I spoke with around half of those contacted between September and November 2013. A broad range of views and opinions were raised, but the majority coalesced around four themes:

- Why had we chosen an individual performance adjustment factor and how would it be applied in practice?

- Why had we reduced the weight of TSR in the LTIP and introduced NTO as a metric?

- Had the Committee set a stretching target for NTO and, more particularly, EPS performance?

- Could the long-term alignment of interests between Executive Directors and shareholders be improved further?

In relation to the first of these, we wanted to be able to recognise outstanding individual performance in supporting strategic delivery (and penalise poor individual performance) in a direct and immediate way. The mechanism to do this ensures that individual performance is only recognised if business performance objectives have been met. One of BAT's distinguishing features and a real source of competitive advantage has been, and continues to be, its strong collegiate culture and the new approach to recognising individual as well as team performance will apply to the entire senior management population, not just the Executive Directors. We were also mindful that while there are good reasons for rewarding individual performance, the quantum needed to be set at a level that acknowledged the cultural context – hence the decision to cap the maximum adjustment factor at 20%. The Committee has agreed that it will provide a full rationale for any application to an Executive Director's IEIS award supplemented by disclosing the distribution of outcomes for the relevant senior management population.

With regard to TSR, we had a very broad range of views with some shareholders expressing concern about the reduction in the overall weight of the TSR components and others saying that we should eliminate TSR altogether. In the round, I believe that retaining the 25% TSR component, assessed against the most relevant competitive set of global companies, is justified. I also believe that the introduction of NTO as an indicator of organic business growth is timely and appropriate. The Committee believes that this organic sales growth measure captures trends fundamental to delivering the Company's strategic objectives – growth of higher margin Global Drive Brands, the impact of product innovation, geographic shifts, developments in pricing and volume – and will serve to strengthen the link between scheme design and business strategy. In order to allay any concerns that incentivising NTO growth might risk rewarding growth in sales without corresponding growth in profit, we have decided that the NTO component will be subject to an economic underpin. No vesting will occur under this measure unless the corresponding three-year compound annual growth rate (CAGR) of underlying operating profit (UOP) at constant currency exceeds the CAGR at the minimum threshold performance levels for UOP as defined in the IEIS.

Remuneration Report
Annual Statement continued

Regarding the specific target and ranges for the measures used for both the annual and long-term incentive schemes, I would point out that these are entirely consistent with the Company's long-term strategy to deliver sustainable high single digit EPS growth while at the same time making very significant revenue and capital investments which will underwrite that sustainability. As described elsewhere in this Annual Report, British American Tobacco is investing in new product developments, in the fast-growing non-combustible arena, in globally integrated information systems – all of which will drive and sustain long-term growth in shareholder value while at the same time delivering a level of financial performance consistent with shareholders' expectations. I believe it is essential that the ranges agreed by the Committee for the NTO and EPS are understood in this business context.

Some shareholders wanted to see a greater emphasis on 'returns' in our incentive programmes. In this regard, please refer to the commentary from our Chief Executive on the Group's return on capital employed (ROCE) in the Chief Executive's Overview in the Strategic Report, where we report on this for the first time. We will keep this matter under review but, for now, the Committee is satisfied that the 60% weighting in the IEIS for delivery of demanding profit and cash targets and 50% weighting for EPS growth in the LTIP provides sufficient focus on hard measures of economic output and cash discipline.

Finally, several investors wanted to see more alignment between the interests of Executive Directors and those of shareholders. In response to these requests, the Committee has incorporated the following elements into the Policy:

- An increase to the minimum shareholding guidelines to 400% of base salary for the Chief Executive and to 250% of base salary for the other Executive Directors (previously 300% and 200% respectively).
- Any long-term incentive awards made from 2014 and outstanding at the date of departure of an Executive Director will not now vest until the original vesting date. Departing Executive Directors will retain an interest in a particular LTIP award's performance for up to two years following their departure.

The Committee recognises its responsibility to exercise and explain to shareholders its judgement in choosing and setting performance targets and concluding on results delivered by management against those targets. The Committee also retains discretion to vary outcomes in exceptional circumstances where the overall application of the schemes produces results that are anomalous or unfair to either management or shareholders and will explain clearly any such exercise of discretion.

We have listened carefully to the points raised by shareholders and the Committee has responded by making several key changes to the original proposals. I am very grateful to those shareholders who engaged with us as we developed the Policy presented here.

Given the practical requirements for the IEIS annual award and the LTIP to be based on full financial years, the Committee has introduced these changes to the policy with effect from 1 January 2014. It will become our Future Policy if approved by shareholders at the AGM in April 2014. I look forward to reporting against it in detail next year.

As the Chief Executive's overview highlights, the Group's performance in 2013, in continued challenging global market conditions, has been robust with strong sales, primarily through a balanced approach to pricing and driving the higher margin Global Drive Brand portfolio, supplemented by a sharp focus on efficiencies to improve margin and deliver healthy growth in operating profit. This strong operating performance has also been reflected in excellent cash conversion to maintain the strength of the Group's balance sheet and enable continuing return of cash to shareholders in the form of dividends and share buy-backs.

This satisfying business performance during 2013 is, I believe, appropriately and accurately reflected in the measures we have chosen to track the Group's performance – in terms of profit and cash, the fundamental strategic yardsticks of market share and Global Drive Brand growth – and in the outcome of the IEIS with awards achieved for the Chief Executive and the Executive Directors of 162.7% and 146.4% of base salary respectively.

The vesting level of the 2011 LTIP at 49.2% is also reflective of the tough global economic environment and in particular currency fluctuations. In spite of achieving a CAGR of 10.7% for EPS when measured on a constant currency basis over the three-year performance period, the recent appreciation of sterling has meant that EPS measured at current rates of exchange has grown only by a CAGR of 4.1% over this period. These substantial currency headwinds have not only reduced reported EPS performance but also held back TSR performance relative to companies which are far less exposed to non-sterling earnings. In this respect, I believe that the changes to the LTIP metrics the Committee has implemented for awards for 2014 and beyond will serve to better align performance outcomes to management performance.

Finally, the Committee agreed the terms of the retirement in April of the outgoing Chief Operating Officer, John Daly, at its February meeting, awarding him 'good leaver' status in respect of long-term incentive plan and deferred annual share plan awards.

The Committee believes it has achieved a fair balance to reward Executives for delivering sustainable value and I hope that we can count on shareholders to support both our policy revisions as well as our annual report on remuneration at the forthcoming AGM.

Gerry Murphy
Chairman of the Remuneration Committee

Remuneration Report
Policy Report

Policy Report

Introduction

This policy section of the Remuneration Report (the 'Policy Report') sets out and describes the policy that has been applied by the Company from 1 January 2014 and which will, subject to shareholder approval at the AGM on 30 April 2014, become the approved policy applicable to Executive Directors for three years from the date of that AGM. If approved, it will be displayed on the Company's website, in the investor relations area, as soon as practicable after the 2014 AGM.

The Policy Report has been prepared in accordance with the relevant provisions of the Companies Act 2006 and on the basis prescribed in The Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013 (the 'Regulations'). Where required, data has been audited by PricewaterhouseCoopers LLP and this is indicated appropriately.

To aid understanding of this report, we have included an explanation of how our forward-looking policy differs from the policy in operation for the 2013 financial year and the process by which these changes were developed and incorporated.

Principles of remuneration

The Committee considers the remuneration policy annually to ensure that it remains aligned with business needs and is appropriately positioned relative to the market. Its overriding objective is to reward the delivery of the Group's strategy in a manner which is simple, straightforward and understandable. The remuneration package comprises core fixed elements (base salary, pension and other benefits) designed to recognise the skills and experience of our Executive Directors and to ensure current and future market competitiveness in attracting talent. In addition, two performance-based variable elements (a single cash and share incentive annual bonus plan (IEIS), and a single long-term incentive scheme (LTIP)) are designed to motivate and reward the delivery of growth to shareholders on a long-term sustainable basis. The performance-based elements form an approximate range of 70% to 80% of the total remuneration package.

This approach has remained largely unchanged for a number of years and following a review in 2013 we believe this approach continues to be generally appropriate. However, a number of revisions to the remuneration policy were proposed as a result of the review and, following discussion with and feedback from shareholders, further changes have been incorporated into our 2014 policy. This is discussed in more detail in the section below.

Policy Review 2013 – Improving Alignment of Remuneration with Shareholders' Interests

The policy review was based on a number of key objectives:

- to ensure that remuneration rewards the delivery of British American Tobacco's strategy;
- to remain aligned to the UK market while enabling the Company to recruit and retain top talent internationally;
- to keep incentive plans as simple and transparent as possible; and
- to ensure that long-term shareholder interests are taken into account in the development of policy.

The Company's strong performance, delivering top quartile total shareholder returns since 2003, provided additional context to the review. We believe that our policy has served shareholders well and rewarded management appropriately for consistent outperformance in previous years. The review focused on the variable compensation components, in particular, the design, award levels, performance metrics and their alignment to medium and long-term strategy. The Company was keen to undertake an engagement process with investors as part of the formulation of the revised policy. The Chairman of the Committee wrote to and offered meetings with some 40 key shareholders and representative groups and discussed the Committee's proposals personally with around half of those contacted.

Summary of key changes

IEIS: Introduction of an individual performance element

We have introduced an individual performance element into the IEIS for all senior management, including Executive Directors. Such a measure strengthens the link between individual performance and reward while aligning both of these elements to British American Tobacco's underlying strategy as reflected in the IEIS performance metrics. Outstanding personal performance can, at the Committee's discretion, result in an Executive Director's overall corporate IEIS bonus being adjusted upwards by up to an additional 10% or 20% of the corporate result. Poor personal performance can, at the Committee's discretion, result in an Executive Director's overall IEIS bonus being adjusted downwards by 50% of the corporate result. The adjustment factor will only apply within the current maximum bonus potential under the IEIS, i.e. 200% for the Chief Executive and 180% for the other Executive Directors.

As a consequence of introducing the adjustment factor to apply for performance in 2014, recognised in 2015, the Committee expects that future salary increases will be aligned with pay inflation in the wider British American Tobacco UK population, except in those exceptional circumstances, such as where a recently appointed Executive Director's salary is increased to reflect his/her growth in the role over time or where significant additional responsibilities are added to the role.

Remuneration Report
Policy Report continued

Annual Incentive Scheme: Change to the Global Drive Brand (GDB) Volume Metric

For 2014, the GDB volume metric has been augmented to include the Rothmans brand as an additional GDB and also the brands State Express 555 and Shuang Xi, being Key Strategic Brands associated with the CNTC joint venture.

Annual Incentive Scheme: Introduction of a claw-back element in respect of the Deferred Share Award component

A malus provision has been introduced into the deferred share element of the IEIS to align it with a similar provision already in existence in our long-term incentive plan. This will apply where the Board considers there has been a material misrepresentation by any person in relation to the performance of the Company and/or the participant which the Board believes has influenced the extent to which any prior award vested or where any other event has arisen which the Board considers, in its absolute discretion, justifies such a reduction.

Long-Term Incentive Plan (LTIP)

A reformulation of the LTIP performance metrics to reinforce alignment with BAT's key strategic objective of delivering sustainable balanced growth.

Net turnover (NTO), multi-year growth in organic sales measured on a constant currency basis, is introduced for the first time. This measure provides the best indicator of business sustainability, capturing elements such as volume and price development, geographic trends, growth of higher margin Global Drive Brands, as well as the impact of product innovation – all key in delivering the Company's growth objectives. The new measure, weighted at 25%, has a target range of compound annual growth (CAGR) of 2–5%, consistent with the Company's strategic objectives for balanced growth in revenue, operating profits and net earnings. To alleviate concerns expressed by some shareholders, this metric is subject to an economic underpin: no vesting will occur for NTO unless the corresponding three-year constant currency CAGR of underlying operating profit exceeds the CAGR of the threshold performance level for underlying operating profit, as defined annually in the IEIS and which is approved by the Board.

The new metric for NTO replaces the total shareholder return (TSR) measure against the FTSE 100 companies. TSR against the more relevant global FMCG comparator group, with its 25% weighting, is retained in 2014.

The existing adjusted diluted earnings per share (EPS) measure is also retained with a 50% weighting within the scheme, but moving to an absolute growth range of 5–10%, based on current rates of foreign exchange, versus the previous range of UK RPI + 3–8%, as UK inflation is of little relevance to the Company's business which is truly global both in terms of asset base and sources of income.

Long-term shareholding by Executive Directors

Our original proposals did not incorporate any changes in this area. However, during the consultation exercise, a number of shareholders expressed a wish to see greater alignment between the interests of Directors and shareholders.

The Committee has therefore decided to increase the shareholding guidelines to 400% of base salary for the Chief Executive (up from 300%) and to 250% of base salary (up from 200%) for other Executive Directors. In addition, any long-term incentive awards granted from 2014 onwards will now vest at the original vesting date with no accelerated vesting if the Director retires during the performance period. As a consequence, departing Executive Directors will retain an interest in a particular scheme's performance for up to two years following their departure.

Future Policy Table – Executive Directors

Base salary

How the element supports the Company's strategic objectives

To attract and retain high calibre individuals to deliver the Company's strategic plans by offering market competitive levels of guaranteed cash; to reflect an individual's skills, experience and role within the Company.

Operation of the element

Base salary is paid in 12 equal monthly instalments during the year.

Salaries are normally reviewed annually in February (with salary changes effective from April) or subject to an ad hoc review on a significant change of responsibilities.

Salaries are reviewed against general UK pay trends and a company size and complexity model based on UK companies, coupled with the Pay Comparator Group (see note 1, page 72). Further reference is also made for discussion purposes only, to published salary data of internationally listed companies of a similar size and complexity. The Committee will exercise its judgement to vary the constituents of the Pay Comparator Group over the life of this remuneration policy.

Base salary is pensionable.

There are no contractual provisions for claw-back or malus in place for this element.

Maximum potential value

Increases from current levels stated in the Annual Report following the 2014 salary review will generally be in line with other UK-based employees in the Group. The salary of a recently appointed Executive Director as he or she progresses in a role may exceed the average salary increase to reflect the accrual of experience. A change in responsibilities may also be reflected in an above average increase in salary. Promotion leading to a complete change of role would be considered in line with the Committee's approach to recruitment.

Year-on-year increases for Executive Directors, currently in role, will not exceed 10% per annum during the policy period.

Performance metrics used, weighting and time period applicable

None.

Benefits

How the element supports the Company's strategic objectives

To provide market competitive benefits consistent with role which:

- allow the attraction and retention of high calibre individuals to deliver the Company's strategic plans; and
- recognise that such talent is global in source and that the availability of certain benefits (e.g. relocation, repatriation, taxation compliance advice) will from time to time be necessary to avoid such factors being an inhibitor to accepting the role.

Operation of the element

The Company currently offers the following contractual benefits to Executive Directors: a car or car allowance; the use of a driver; tax advice (in instances where multi-jurisdictional tax authorities are involved); tax equalisation payments (where appropriate); private medical insurance, including general practitioner 'walk-in' medical services; personal life and accident insurance; relocation and shipment of effects and associated expenses on appointment and at the end of tenure, in each case where the individual is not a long-term resident of the UK (including housing and education allowances or similar arrangements as appropriate to family circumstances). Other benefits not identified above may be offered, if in the Committee's view, other benefits are necessary in order to remain aligned with market practice.

Remuneration Report
Policy Report continued

Other benefits, such as legal fees spent in reviewing a settlement agreement on departure may also be provided where appropriate.

With the exception of the car or car allowance, it is also practice to pay the tax that may be due on these and any similar benefits.

Further, HM Revenue & Customs may classify the provision of certain services and payments as taxable benefits. These include: the installation and maintenance of home security systems; the reimbursement of travel and related expenses; and other expenses incurred in connection with individual and/or accompanied attendance at certain business functions and/or corporate events. It is also the Company's practice to pay the tax that may be due on these types of benefits.

Maximum potential value

The maximum potential values are based on market practice for individuals of this level of seniority and considerations of a cost that is affordable to the business together with a range of benefits consistent with market practice.

The maximum annual benefit that can be offered for each element is:

- car or car allowance: £20,000 (subject to periodic inflation-related increases);
- use of a company driver: variable maxima as the actual cost is dependent on the miles driven in any year;
- variable maxima will apply to the cost of private medical insurance which is dependent on an individual's medical history and is provided on a family basis;
- GP 'walk-in' facility: £5,000 per annum;
- personal life and accident insurance designed to pay out at a multiple of four and five times base salary respectively;
- international tax advice as required, but not exceeding £30,000; and tax equalisation payments as agreed by the Committee from time to time; and
- relocation and shipment expenses for non-UK citizens at the beginning and end of service as an Executive Director (if appropriate) up to £200,000 together with housing and education allowances or other similar arrangements appropriate to the individual's family circumstances.

It is the Company's practice, in addition to providing the benefits to the values stated above, to also pay the tax that may be due on these and other similar benefits.

There are no contractual provisions for claw-back or malus.

Performance metrics used, weighting and time period applicable

None.

Pensions

How the element supports the Company's strategic objectives

To provide competitive post-retirement benefit arrangements recognising both the individual's length of tenure with the Group and the external environment in the context of attracting and retaining high calibre individuals to deliver the Group's strategy.

Operation of the element

British American Tobacco UK Pension Fund (the 'Pension Fund') – non-contributory defined benefit section

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 defined benefit section closed to new members with effect from 1 April 2005.

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

British American Tobacco UK Pension Fund – defined contribution section

Individuals joining the organisation since April 2005 participate in a defined contribution arrangement. On the appointment of a new Executive Director a contribution of up to the equivalent of 35% of base salary would be made. The actual level of contribution paid to the Pension Fund is restricted to take into account the annual allowance and lifetime allowance with any balance payable as a gross cash allowance.

Unfunded unapproved retirement benefit scheme (UURBS)

The Pension Fund retains a scheme-specific salary cap, currently £141,600 effective 1 April 2013, which is adjusted in April each year in line with the Retail Prices Index as at September of the previous year. Where an individual is entitled to benefits calculated on a base salary that exceeds the scheme-specific cap, these are accrued in the Company's UURBS. Pension accrual in the UURBS will not exceed the accrual rate applicable to the individual in respect of their Pension Fund entitlement (maximum 1/40th per annum). In addition, where pension accrual in the Pension Fund exceeds the UK regulated annual and lifetime allowances, subject to the individual's consent, benefits are adjusted to remain within these limits with any excess being provided through the UURBS.

Upon retirement, Executive Directors who have accrued benefits in the UURBS will have the opportunity to receive this element of their overall entitlement either in the form of a single lump sum or as an ongoing pension payment. Lump sums in lieu of a pension entitlement in the UURBS are subject to a decrement of between 19% and 21%, depending on age. In addition, a further reduction that recognises the Company's liability to employer's national insurance will also be made.

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

Maximum potential value

Internal appointees as Executive Directors may have existing defined benefit or defined contribution pension entitlements with the Group which will ordinarily remain unchanged. Pension benefits and entitlements will continue to be calculated with reference to an individual's base salary.

Pension entitlements for external appointees as Executive Directors will be subject to negotiation taking into account the relevant annual and lifetime allowances; will be defined contribution in nature and will not exceed 35% of base salary in value.

Performance metrics used, weighting and time period applicable

There are no performance metrics.

Pensions in payment are paid monthly or quarterly in accordance with the rules of the relevant section of the Pension Fund.

Short-term incentives: International Executive Incentive Scheme (IEIS)

How the element supports the Company's strategic objectives

To incentivise the attainment of corporate targets aligned to the strategic objectives of the Company on an annual basis.

Performance-based award in the form of cash and deferred shares, so that the latter element ensures alignment with shareholders' long-term interests.

Strong alignment and linkage between individual and corporate annual objectives via the application of an individual performance adjustment factor to the corporate result.

To ensure, overall, a market competitive package to attract and retain high calibre individuals to deliver the Group's strategy.

Operation of the element

IEIS comprises an annual award referenced to base salary which is normally paid approximately three months after the end of the financial year to which it relates: 50% is paid immediately in cash and 50% of the total bonus amount is awarded in shares through the Deferred Share Bonus Scheme – DSBS.

Deferred shares attract a cash payment equivalent to the dividend on the after-tax position of all of a participant's unvested ordinary shares held in the DSBS at the dividend record date.

Any individual performance element awarded (being an adjustment factor of either 10% or 20% of the annual corporate result) is paid in cash. In cases of identified poor individual performance, the corporate result will be reduced by 50%.

Remuneration Report
Policy Report continued

The Remuneration Committee sets the performance targets each year and is able to vary the exact measures and the weighting of them from year to year.

The corporate result under the IEIS for the prior year is based on achievement against targets set and is reviewed by the Remuneration Committee in February each year. The Group's external auditors adopt specified procedures to assist the Committee's assessment of the calculations used to determine the IEIS corporate bonus outcomes and future targets.

The total payout is determined by the Company's performance under each measure relative to that measure's performance target. The Committee may adjust the payout in circumstances where, in its judgement, the overall performance of the Company warrants a different outcome, whether higher or lower, than that determined by the application of the bonus formula.

A malus facility has been introduced under which part or all of a DSBS award can be recovered where there has been a material misrepresentation by any person in relation to the performance of the Company and/or the participant which the Board believes has influenced the extent to which any prior award vested or where any other event has arisen which the Board considers, in its absolute discretion, justifies such a reduction.

Awards under the annual incentive scheme are not pensionable and no element of the bonus is guaranteed.

Maximum potential value and payment at threshold

The maximum annual bonus opportunity for the Chief Executive (including any individual adjustment factor) is 200% of base salary. The equivalent bonus opportunity for the other Executive Directors is 180% of base salary. The individual adjustment factor is capped so that under no circumstances can the maximum award levels of 200% and 180% respectively be exceeded. No bonus is paid at the threshold level of performance, which must be exceeded for any element of the bonus to be paid.

The annual 'on-target' bonus opportunity for the Chief Executive is 100% of base salary (increasing up to 120% if the Committee assesses individual performance as outstanding and applies the individual adjustment factor at 20% to an 'on-target' corporate result) the maximum award under any circumstances is 200% of salary.

For the other Executive Directors, the 'on-target' bonus opportunity is 90% (increasing up to 108% if the individual adjustment factor is awarded at a 20% level, based on an 'on-target' corporate result) with a maximum opportunity under any circumstances capped at 180% of base salary.

Performance metrics used, weighting and time period applicable

For 2014, the IEIS contains four corporate performance measures and weightings measured over the financial year:

(1) Adjusted profit from operations (40%) – this is the profit from operations of the Group's subsidiaries at constant rates of exchange adjusted for the items shown as memorandum information in the Group Income Statement. It is the Group's medium to long-term aim to grow adjusted profit from operations on average by 6% annually.

(2) Increase in the Group's share of key markets (20%) – this is the Group's retail market share in its key markets, which accounts for around 80% of the volumes of the Group's subsidiaries. The aim is to increase the Group's share year on year. The information used in this calculation is based on information (available on subscription) on retail audit share. The process is subject to rebasing as and when the Groups' key markets change. When rebasing occurs to reflect changes in the sample or estimated market size, the Company will also restate history and provide fresh comparative data on the markets.

(3) Global Drive Brand and Key Strategic Brands volumes (20%) – this comprises: (1) the cigarette volumes of the following GDB brands sold by the Group's subsidiaries: Dunhill, Kent, Lucky Strike, Pall Mall and Rothmans (a new addition as a GDB from 2014), including volumes of the Fine Cut variants of the above brands sold in Western Europe; and (2) the cigarette volumes of State Express 555 and Shuang Xi, being Key Strategic Brands associated with the CNTC joint venture.

The aim is to improve the quality of the Group's portfolio by increasing the volume of GDBs faster than the rest of the brands in the Group's portfolio.

(4) Cash flow from operations (20%) – is defined as the free cash flow excluding restructuring costs, dividends and other appropriations from associate undertakings as referenced to the cash flow and net debt movements. The aim is to generate the optimal level cash flow while continuing to invest to support the short, medium and long-term requirements of the business. A specific target is set each year.

Three levels of award attainment relative to the measures are defined under the IEIS:

(1) Threshold (which must be exceeded to attract any bonus pay-out in respect of that measure);

(2) Target (which amounts to the budgeted performance); and

(3) Maximum (the level of performance exceeding budget and at which the bonus pay-out for that measure is capped).

An award is pro-rated in respect of attainment between the measures set out above. The specific performance targets for each measure are considered to be commercially sensitive and are not disclosed. Indicative performance against them will be disclosed in the Annual Report on Remuneration in the following year.

An individual performance element may also be awarded by the Remuneration Committee based on its assessment of the Executive Director's performance against specific individual KPIs set at the beginning of the year. This element is applied to the corporate result but is subject to the maximum award limit as explained above.

Long-term incentives: Long-Term Incentive Plan (LTIP)

How the element supports the Company's strategic objectives

To incentivise long-term sustainable growth in total shareholder return (TSR), adjusted diluted earnings per share (EPS) and net turnover (NTO), over a three-year period; and to attract and retain high calibre individuals required to deliver the Company's strategic plans.

To put in place a combination of measures with appropriately stretching targets around the long-term plan which provides a balance relevant to the Company's business and market conditions as well as providing alignment between Executive Directors and shareholders. In setting performance criteria and thresholds/targets, the Committee takes account of the Group's long-term plans and market expectations.

Operation of the element

Discretionary annual awards of shares with vesting levels based on the achievement of defined and appropriately stretching targets which for 2014 are relative TSR, EPS growth and NTO growth aligned to Group's strategic objectives over a three-year performance and vesting period.

TSR – performance is measured against a peer group of international FMCG companies using the return index calculated by Datastream and reviewed by the Company's remuneration consultants. TSR is measured on the basis that all companies' dividends are reinvested in the shares of those companies. The return is the percentage increase in each company's index over the three-year performance period. The opening and closing indices for this calculation are respectively the average of the index numbers for the last quarter of the final year of that performance period – this methodology is employed to reflect movements of the indices over that time as accurately as possible.

A local currency basis is used for the purposes of TSR measurement. This approach is considered to have the benefits of simplicity and directness of comparison with the performance of the comparator companies.

EPS – growth in adjusted diluted EPS for these purposes incorporates an increase in adjusted diluted EPS between the base year and the final year of the performance period, expressed as an annual growth rate over the period.

NTO – is defined for these purposes as growth in gross turnover less excise, duties and rebates and is considered as the most appropriate measure of the Company's long-term business sustainability. No vesting will occur for NTO unless the corresponding three-year constant currency compound annual growth rate (CAGR) of underlying operating profit exceeds the CAGR of the threshold performance level for underlying operating profit, as defined annually in the IEIS, as approved by the Board.

LTIP awards vest only to the extent that the performance conditions are satisfied at the end of the three-year performance period. The Remuneration Committee may apply its discretion to vary the outcome of the formulaic performance to ensure a fair result for both the Executive Directors and the shareholders.

Participants are entitled to receive a dividend equivalent payment to the value of the dividends that they would have received as shareholders on their vesting awards. Any proportion of an award that lapses does not attract the payment of the LTIP dividend equivalent payment.

A malus facility is in operation under which a part or the whole of the LTIP award can be recovered where there has been a material misrepresentation by any person in relation to the performance of the Company and/or the participant which the Committee believes has influenced the extent to which any prior award vested.

The Remuneration Committee is able to vary the exact measures and the weighting of them from year to year, but will generally only seek to make amendments to them following consultation with shareholders.

Note – the Remuneration Committee will also assess the performance of the LTIP awards made in 2012 and 2013 against the performance conditions applicable to those awards and which are set out in the notes to this Future Policy Table.

Remuneration Report
Policy Report continued

Maximum potential value and payment at threshold

Maximum award of shares permitted is 400% of salary for the Chief Executive and 300% for other Executive Directors. Proportion of vesting is determined by reference to achievement of defined targets over a three-year performance period in respect of three measures:

- earnings per share (50%);
- total shareholder return (25%); and
- net turnover (25%).

A maximum vesting of 100% will result in the vesting of shares to a value equivalent to 400% of the Chief Executive's salary as at the time of award, plus the appropriate dividend equivalent payment. For other Executive Directors, a maximum vesting 100% will result in the vesting of shares to a value of 300% of salary as at the time of award, plus the applicable dividend equivalent payment.

If the threshold performance level were to be attained in respect of all three measures, 20% of the original award level in respect of the Chief Executive – shares with a value equivalent to 80% of salary – would vest, plus the appropriate dividend equivalent attaching to the shares vesting. A threshold performance outcome for the other Executive Directors would result in 20% of the original award level vesting. This amounts to shares with a value equivalent to 60% of salary, plus the appropriate dividend equivalent payment.

Performance metrics used, weighting and time period applicable

Performance conditions must be met over a three-year period in respect of three measures:

(1) 25% of an LTIP award based on the Company's TSR performance against a peer group of international FMCG companies (see note 2, page 72). In the event of a top quartile performance by the Company relative to this comparator group, this element of the award vests in full. 6% vests for median performance and there is a pro rata vesting between these two points. The TSR portion of an LTIP award will not vest for below median performance.

(2) 50% of an LTIP award is based on adjusted diluted EPS growth measured at current rates of exchange. If the Company achieves a compound annual growth rate of 10%, this element of the award will vest in full. If 5% growth is achieved, then 8% of the award will vest. For performance between these two points, a pro-rated award will vest. If EPS growth over the period is less than 5%, none of the EPS portion of an award will vest.

(3) 25% of an LTIP award is based on the compound annual growth rate of NTO measured at constant rates of exchange. If the Company achieves a growth rate of 5%, this element of the award relating to NTO will vest in full. If the Company achieves a compound annual growth rate over the three-year period of 2%, then 6% of the award will vest in full. There is a pro rata vesting between these points. The NTO portion of the LTIP award will not vest for growth below 2%.

There is an underpin to the NTO measure whereby the corresponding three-year constant currency CAGR of underlying operating profit must exceed the CAGR of the threshold performance level for underlying operating profit (as defined annually in the IEIS and approved by the Board) in order for an LTIP vesting payment in respect of the NTO measure to become payable.

All-employee share schemes

How the element supports the Company's strategic objectives

Executive Directors are eligible to participate in the Company's all-employee share schemes which are designed to incentivise employees by giving them an opportunity to build shareholdings in the Company.

Operation of the element

Sharesave Scheme – an HM Revenue & Customs (HMRC) approved scheme where eligible employees are granted savings-related share options to subscribe for ordinary shares in the Company. Options are granted to be exercisable in conjunction with either a three-year or five-year savings contract with a monthly savings limit of £250. Options are normally granted at a discount of 20% to market price at the time of invitation. Further to recent changes in legislation, the monthly savings limit will increase to £500; the Company intends to apply this new savings limit during the lifetime of this policy.

Share Incentive Plan (SIP) – an HMRC-approved plan incorporating:

(1) Partnership Scheme – eligible employees can allocate part of their pre-tax salary up to a maximum of £1,500 in any year to purchase shares in Company. Shares purchased are held in a UK-based trust, normally capable of transfer to participants tax-free after a five-year holding period. Further to recent changes in legislation, the annual value of 'partnership shares' that can be purchased will increase to £1,800; the Company intends to apply this new limit during the lifetime of this policy.

(2) Share Reward Scheme – eligible employees receive an award of shares in April of each year in which the Scheme operates in respect of performance in the previous financial year. The performance conditions are aligned to those set for the IEIS in respect of the same performance period. The plan shares are held in a UK-based trust for a minimum period of three years and during that time the trust will exercise its voting rights as directed by the plan's participants. The maximum individual award under the Share Reward Scheme is £3,000. Further to recent changes in legislation, the annual value of 'free shares' that can be awarded to employees will increase to £3,600; the Company intends to apply this new limit during the lifetime of this policy.

Maximum potential value

Sharesave Scheme: the market value of the shares under option at the date of maturity of the Sharesave savings contract, less the grant price of the option at the contract start date.

SIP – Partnership Scheme: the value of the shares purchased out of the potential maximum annual purchase value of £1,800 at the end of the five-year holding period.

SIP – Share Reward Scheme: the value of the shares awarded out of the potential maximum annual award value of £3,600 at the end of the three-year holding period.

Performance metrics used, weighting and time period applicable

See above.

Shareholding guidelines

How the element supports the Company's strategic objectives

To strengthen the alignment between the interests of the Executive Directors and those of the shareholders by requiring Executive Directors to build up a high level of personal shareholding in the Company.

Operation of the element

Executive Directors are required to hold shares in the Company equal to the value of a multiple of salary. Arrangements apply to those Executive Directors who do not, at any point, meet the requirements of the shareholding guidelines. Individuals may sell a maximum of up to 50% of any shares vesting (after tax) under the Company's share plans until the threshold for the shareholding guidelines has been met. Shares earned but not yet vested under the Company's share incentive plans are not taken into account when assessing compliance.

Maximum potential value

Chief Executive: 400% of salary.

Other Executive Directors: 250% of salary.

Performance metrics used, weighting and time period applicable

None.

Remuneration Report
Policy Report continued

External Board appointments

How the element supports the Company's strategic objectives

The Company recognises the opportunities and benefits that accrue to both the Company and its Executive Directors who serve as Non-Executive Directors on the Boards of comparable companies.

Operation of the element

Each Executive Director is limited to one external appointment, with the permission of the Board.

Maximum potential value

Any fees from such appointments are retained by the individual in recognition of the increased level of personal commitment required. Executive Directors may also serve as nominated directors on the Boards of the Company's associate undertakings. In such instances, the fees will be paid to the Group and are not for the individual's account.

Performance metrics used, weighting and time period applicable

None.

Notes:

1. The constituents of the Pay Comparator Group used in the review of base salary at the date of this report are as follows:

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

2. The current constituents of the FMCG peer group used to assess the Company's TSR performance in respect of an LTIP award and as at the date of this report are as follows:

Anheuser-Busch InBev	Imperial Tobacco Group	PepsiCo
Campbell Soup	Japan Tobacco	Pernod Ricard
Carlsberg	Johnson & Johnson	Philip Morris International
Coca-Cola	Kellogg	Procter & Gamble
Colgate-Palmolive	Kimberley-Clark	Reckitt Benckiser
Danone	LVMH	SABMiller
Diageo	Mondeléz International	Unilever
Heineken	Nestlé	

3. During the year ended 31 December 2013, the Company undertook an extensive programme of communication with its key shareholders on changes to its remuneration policy. This is described in more detail earlier in this Policy Report section of the Remuneration Report. The following sets out the key changes to the previous remuneration policy of the Company which was in place during the year ended 31 December 2013:

Short-term incentives: IEIS

The definition of brands constituting the Global Drive Brand performance measure has been extended. For 2014, it comprises (1) the cigarette volumes of the following GDB brands sold by the Group's subsidiaries: Dunhill, Kent, Lucky Strike, Pall Mall and Rothmans (a new addition as a GDB from 2014), including volumes of the Fine Cut variants of the above brands sold in Western Europe; and (2) the cigarette volumes of State Express 555 and Shuang Xi, being Key Strategic Brands associated with the CNTC joint venture.

For the deferred share element of awards made from 2014 onwards, a malus provision has been introduced under which part or all of this deferred share bonus can be recovered where there has been a material misrepresentation by any person in relation to the performance of the Company and/or the participant which the Board believes has influenced the extent to which any prior award vested or where any other event has arisen which the Board considers, in its absolute discretion, justifies such a reduction.

An individual performance element has been introduced for performance in 2014, recognised in 2015, to further align individual performance and reward outcomes to those of the Company. An individual can receive an additional 10% or 20% of the corporate result for outstanding performance. However, the application of this performance adjustment is capped so that the maximum bonus opportunity available to the Chief Executive and the other Directors of 200% and 180% respectively cannot be exceeded. Poor personal performance by an individual can result in an overall IEIS bonus being adjusted downwards by 50% of the corporate result.

Long-term incentives: LTIP

For performance periods and awards commencing in 2014, the LTIP metrics will move from two to three measures. The measures existing at the time of the awards apply to the following LTIP awards: May 2011 LTIP awards (vesting 13 May 2014); March 2012 LTIP awards (vesting 28 March 2015) and March 2013 LTIP awards (vesting 22 March 2016).

Measures applying from 2014 (vesting in 2017)	Measures applying for 2011, 2012 and 2013 awards
EPS: compound annual growth of 5% (threshold) to 10% (maximum), measured at current rates of exchange. Component weighting: 50%.	EPS: compound annual growth of 3% (measured at current rates of exchange) in excess of UK inflation triggers threshold performance. Growth of 8% in excess of inflation would trigger maximum vesting under this measure. Component weighting – 50%. Details of the calculations supporting this measure are set out in the Annual Report on Remuneration.
TSR: relative to and measured against a group of international FMCG companies (consistent with previous years). To achieve threshold vesting, median performance must be achieved versus this group. If top quartile or above performance is achieved, maximum vesting under this metric is triggered. Component weighting: 25%.	TSR: relative to and measured against two groups of companies: i) a group of international FMCG companies (weighting 25%) and ii) the constituents of the London Stock Exchange's FTSE 100 Index (weighting 25%). Details of the calculations supporting this measure are set out in the Annual Report on Remuneration.
NTO: compound annual growth of 2% (threshold) to 5% (maximum), measured at constant rates of exchange. There is an underpin to this measure whereby vesting will only be triggered if (assuming threshold or above is achieved in respect of the measure) the corresponding three-year constant currency CAGR of underlying operating profit exceeds the CAGR of the threshold performance level for underlying operating profit, as defined annually in the IEIS and which is approved by the Board. Component weighting: 25%.	N/A

In respect of LTIP awards made from 2014 and beyond, departing Executive Directors will receive vesting shares, conditional upon plan performance, based upon the final vesting percentage measured over the full three-period of the award. There will be no application of an early vesting percentage in respect of long-term incentive plan awards made in or after 2014. As a consequence, departing Executive Directors will continue to have an interest in a particular LTIP award's performance for periods of approximately two years following their departure from their role.

Shareholding guidelines

With effect from 1 January 2014, the minimum shareholding requirements of the Chief Executive and the other Executive Directors are increased from 300% to 400% and from 200% to 250% of base salary respectively.

4. The Remuneration Committee reserves the right to make any remuneration payments where the terms were agreed prior to an individual being appointed an Executive Director of the Company or prior to the approval and implementation of the Remuneration Policy. This includes the achievement of the applicable performance conditions, for Executive Directors who are eligible to receive payment from any award made prior to the approval and implementation of the Remuneration Policy.

Remuneration Report
Policy Report continued

5. The policy in relation to the remuneration of the Executive Directors applies in a similar form, with appropriate eligibility criteria and gradations of salary, benefits and incentive awards to the members of the Management Board and senior management. The senior management population (below Management Board) operates within a job grading structure and its most senior members may participate in both the LTIP and IEIS incentive arrangements. Award levels vary with seniority up to the appropriate maxima expressed within the relevant scheme rules. Performance measures in both LTIP and IEIS are aligned across the Group and for the IEIS locally relevant targets are set as appropriate. More junior members of the senior management population participate in the IEIS only.

   For UK employees of the Group, remuneration will cover annual base salary, retirement plus other benefits and participation in the Company's annual short-term incentive scheme, including eligibility to participate in all-employee share plans.

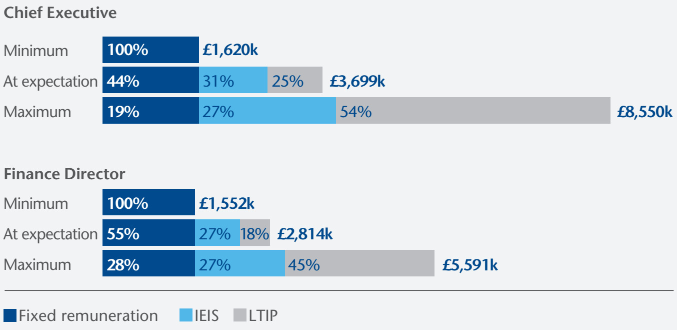
   For employees employed outside of the UK, remuneration policy is set in accordance with conditions in the local market place. Local policy is established with reference to Group guidelines concerning: annual base salary relative to the local market, the provision of retirement and other benefits (where locally relevant) and participation in short-term incentive plans where the incentive opportunity is established with reference to the local market conditions.

Illustrations of the application of the remuneration policy

The levels of remuneration received by Nicandro Durante and Ben Stevens as Executive Directors for the first complete year in which the policy applies are shown as the hypothetical values of their remuneration packages under different performance scenarios in the charts below. No share price growth has been assumed and benefits from all-employee share schemes (Sharesave Scheme and Share Incentive Plan) have been excluded.

The Regulations do not mandate the measurement basis for the components of the bar charts. The Company has made reference to the GC100 and Investor Group Guidance (October 2013) and for the purposes of the bar charts the description 'at expectation' means: (1) IEIS outcome at 'on-target' performance; and (2) LTIP outcome at threshold performance for each specific LTIP measure.

Remuneration outcomes for varying levels of performance



The remuneration outcomes charts have been prepared on the basis of the following assumptions.

Maximum award opportunities (% of salary)	Chief Executive	Finance Director
IEIS	200%	180%
LTIP	400%	300%
Minimum	Fixed pay only:	– No bonus payout – No vesting under the LTIP
At expectation	Fixed pay plus:	– 50% payout of the IEIS – 20% vesting under the LTIP
Maximum	Fixed pay plus:	– 100% payout of the IEIS – 100% vesting under the LTIP

	Salary effective 1 April 2014 £'000	**Benefits value for 2013[1] £'000**	**Pension value for 2013 £'000**	**Total fixed pay £'000**
Chief Executive (Nicandro Durante)	1,155	158	307	1,620
Finance Director (Ben Stevens)	842	103	607	1,552

Note:
1. Benefits value for 2013 excludes: (1) any non-recurring payments; and (2) other expenses incurred in connection with individual and/or accompanied attendance at certain business functions and/or corporate events.

John Daly will retire as an Executive Director in April 2014 and has therefore not been included in the above scenarios. Details of his remuneration and entitlements upon departure will be released on the relevant regulatory news services and disclosed on the Group's website as soon as practicable. They will also be reported in the Annual Report on Remuneration for the year ending 31 December 2014.

Other policy provisions in relation to Directors' pay

The Remuneration Committee makes the following additional disclosures in respect of Directors' pay.

Flexibility, judgement and discretion

The Company's remuneration policy needs to be capable of operating over a three-year period. As such, the Committee has taken care to prepare and explain how the policy will operate and has built in a degree of flexibility to enable the practical implementation of the policy over that prospective lifetime.

(1) Flexibility

Areas of the policy which include a degree of flexibility are around:

- pay and benefits, allowing the Committee to set pay either on appointment or following an annual salary review, and to review and change the pay comparator groups to ensure they remain appropriate. The degree of flexibility to operate is constrained by the policy maximum;
- the IEIS bonus plan, for example, allowing the Committee to design performance measures, agree their relative weighting and set annual targets to incentivise business outcomes aligned to the Group's short-term strategic objectives. This is to ensure that these remain relevant and aligned to the Group strategy; and
- the LTIP, allowing the Committee to make revisions to the performance measures, their respective weightings, threshold and target levels as permitted under the scheme rules.

(2) Judgement

The Committee will be required to exercise its judgement in many ways throughout the year, specifically in those areas of the policy where there is some flexibility. This may occur, for example, when considering an individual's remuneration award or the specific benefits applying to an appointment, or in varying the measures and their weightings, as well as setting specific targets, for example, in the IEIS in any year to ensure that all elements continue to remain aligned to Group strategy and drive the right behaviours. Judgement is also applied in determining the percentage of salary (up to the maximum set out in the policy table) which can be earned as a bonus in excess of threshold, target and up to the maximum, or the percentage salary level (again up to the maximum in the policy table) in respect of an LTIP award. Judgement is also required in assessing the performance of each individual Executive Director in delivering against his or her personal performance objectives.

(3) Discretion

The Committee may also, on more limited occasions, exercise its discretion either upwards or downwards to ensure fair outcomes for both Directors and shareholders notwithstanding the application of the policy.

The Committee has reserved its ability to exercise its discretion as follows:

Short-term incentives (IEIS):

- to assess whether a personal performance adjustment factor should be applied to an Executive Director's bonus outcome and at what level (+10% or +20% for outstanding personal performance or -50% for poor personal performance), subject to the overall cap as provided in the policy;
- in relation to leavers as to whether deferred shares will be released and whether any bonus (in whole or in part) is payable during the year of departure;
- whether circumstances have arisen which should result in the application of the malus provisions to deferred shares held by an Executive Director.

Long-term incentives (LTIP):

- to assess and override the formulaic outcomes of the LTIP performance outcome to ensure that the resulting LTIP pay-out reflects fairly the underlying performance of the business and serves the interest of shareholders;
- in relation to leavers as to whether shares will vest, the terms on which such shares will vest and the percentage level of the award which vests as well as whether any LTIP (in whole or in part) is payable during the year of departure;
- whether circumstances have arisen which should result in the application of the malus provisions to unvested LTIP awards.

Other:

- on appointment of a new Executive Director, to agree a contract, for an initial period only, longer than the normal one-year rolling contract; and
- where the shareholding requirements are not yet met to determine and vary the terms which apply to ensure compliance and/or the retention of deferred shares or vesting LTIP shares to meet the requirement.

In each case, wherever the Committee exercises its discretion in relation to an Executive Director, it will disclose the rationale for doing so in its annual report on remuneration the following year.

Approach to remuneration of Directors on recruitment

British American Tobacco seeks to appoint high calibre managers and many of its competitors for talent are outside the UK.

In appointing a new Executive Director (an internal or external appointee) or promoting an existing Executive Director, the Committee will, within the maxima set out in the Future Policy Table, apply the following principles:

- To offer a package (both fixed and performance-related remuneration) which is sufficiently competitive (but not excessively so) to attract, retain and motivate appropriate candidates for the role. It will consider the market, as defined by the remuneration comparator group, and by reference to other companies of equivalent size and complexity to ensure that it does not overpay;
- Consideration will be given to relevant factors, such as the candidate's skills, knowledge and experience and his or her current location in determining the overall package;
- Internal pay relativities and the terms and conditions of employment of the new and existing Executive Directors will be considered to ensure fairness as between Executive Directors.

Where an external appointment is made to the role of Executive Director and that individual has variable remuneration arrangements with his or her previous employer that will be lost on joining the Company, the Committee will also consider matching up to the maximum of the expected value of the lost awards in order to facilitate the recruitment of that individual. This may take the form of a one-off long-term incentive award with performance conditions and vesting period, similar to those for the awards given up. In addition, a sign-on award may be made on a like-for-like basis to compensate for any short-term incentives which may be forgone. Any cash-based awards will normally only be used to replace a bonus that is within three months of the end of the financial year and where the outcome is reasonably foreseeable. Where appropriate, such awards will also be made subject to malus provisions.

In the event that an appointee would need to relocate to the UK from overseas, the Company would provide appropriate relocation support, which would include: the shipment of personal goods to the UK, the provision of relocation support to find accommodation, the provision of tax support services provided by the Company's external advisers, the payment by the Company of the cost of spouse or partner career counselling, and the provision of housing and schooling support for up to four years as appropriate for the individual's family circumstances.

Executive Directors' service contracts

All of the current Executive Directors are employed on a one-year rolling contract, executed at the time of the original appointment. The contracts are governed by English law and 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.

Two or three-year contracts may be agreed (at the discretion of the Remuneration Committee) in the event that an Executive Director is recruited externally or from overseas. Contracts with an initial period of longer than one year will then reduce to a one-year rolling contract after the expiry of the initial period.

Remuneration Report
Policy Report continued

These contracts place the following obligations on the Company which could give rise to, or impact upon, the remuneration or payments for loss of office of the Executive Directors:

- To provide pay, contributions to applicable pension arrangements and benefits (whether in cash or kind) as specified in the contract, and to reimburse expenses incurred by the Executive Director in performing their duties.
- To give the Executive Director eligibility to participate in: (1) short-term (IEIS) and long-term (LTIP) incentive plans; and (2) all employee share plans, subject to the rules of those schemes.
- To provide for the use of: (1) a company car for private and business use, subject to the terms of the Company's car policy or to provide a monthly car allowance; and (2) the personal use of a car and driver.
- To provide 25 working days' (plus public holidays) paid holiday per annum and to provide pay in lieu of any accrued but untaken holiday on termination of employment.
- To provide sick pay as specified in the contract.
- To give the Executive Director eligibility to participate in the following benefit schemes: private medical expenses scheme; personal accident scheme; and life assurance scheme, subject to the terms and conditions of such schemes from time to time in force.
- Subject to the termination, garden leave and suspension provisions of the service contract, to provide continued employment in the role to which the Executive Director has been appointed.
- To terminate the contract only on the expiry of 12 months' written notice, or to make a payment in lieu of notice equal to the value of (1) 12 months' salary at his or her then current base pay; and (2) a cash payment in respect of benefits under the contract such as medical insurance, or the Company may, at its option, continue those benefits for a 12 month period; see below for the treatment of short-term and long-term share incentive awards on termination.
- In addition to the contractual rights to a payment on loss of office, Executive Directors will have statutory and/or common law rights to certain additional payments, (for example, in a redundancy situation) available to all employees.

It is not currently intended that future service contracts for Executive Directors would contain terms differing materially from those summarised above and in the Future Policy Table.

Copies of the Executive Directors' service contracts are available for inspection at the Company's registered office. These contracts are amended annually following the salary review and the dates of the latest service contracts are shown below:

Executive Directors	Execution date of current service contract
Nicandro Durante	10 Dec 2010
Ben Stevens[1]	26 Mar 2008
John Daly	24 Oct 2010

Note:

1. Ben Stevens: as amended by a side letter dated 23 July 2010 to take account of additional responsibilities upon appointment as Chief Information Officer from 1 September 2010.

Policy on payment for loss of office

The service contracts of the current Executive Directors are terminable on the expiry of 12 months' notice from either the Director or the Company – which means that, where an internal successor has not been identified the Company would have sufficient time to replace the Executive Director through an orderly external recruitment process and ideally have a period of handover.

The principles on which the determination for payments on termination will be approached are as follows:

- Compensation for loss of office in service contracts is limited to no more than 12 months' salary and benefits excluding pension. This amount would be payable where the requisite 12 months' notice is not given to the Executive Director or when the Executive Director terminates by giving 12 months' notice and the Company does not wish the Executive Director to serve the notice.
- If an Executive Director is required to serve a period of notice, the compensation payment is reduced pro rata. In the event that the contract is terminated for cause (such as gross misconduct), the Company may terminate the contract with immediate effect and no compensation would be payable.
- In cases of underperformance, termination payments will not exceed 12 months' salary and benefits.

Awards under share incentive schemes: Executive Directors do not have contractual rights to the value inherent in any awards held under the share incentive schemes, whose rules make provision for vesting in different leaver scenarios. The next table illustrates how entitlements under these plans are managed on termination.

Plan	'Good leaver' (being death, disability, ill health, redundancy and other circumstances at the Committee's discretion)	'Other' leaver scenarios
International Executive Incentive Scheme (IEIS)	The Company's policy is that, as provided for in the rules of the IEIS, 'good leavers' are entitled to a bonus pro-rated to the period of service during the year, payments are cash only. Awards made under the Deferred Share Bonus Scheme (DSBS) component of IEIS 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 scheme.	No entitlement to a bonus under the IEIS but the Committee has the discretion to treat other leavers in the same manner as 'good leavers'. This discretion will not be exercised in the case of summary dismissal.
Long-Term Incentive Plan (LTIP)	Under current plan rules 'good leavers', vesting is dependent on performance to date of leaving and pro-rated for period employed. For awards made from 2014 onwards and vesting on or after 2017, 'good leavers' vesting is dependent on final performance at the end of the performance period and pro-rated for period employed.	In all other circumstances, the awards will lapse immediately unless the Committee, in its absolute discretion, decides otherwise.
Share Reward Scheme	This all-employee scheme award is not forfeited. The Company's policy is that if an individual ceases to be employed within three years of the allocation date, the shares, and at the Trustee's discretion, the dividend shares, will be withdrawn from trust and transferred to the individual.	In cases of dismissal from the Company awards will lapse.

Executive Directors may leave employment for a broad variety of reasons which may not necessarily fall within the prescribed category of 'good leaver'. Accordingly, the Committee retains discretion in determining 'good leaver' status which is intended to provide flexibility in certain circumstances. 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 the individual:

- resigns intending to cease work altogether (indicative of 'good leaver' status and discretion to release awards);
- resigns intending to take up a different occupation, such as a portfolio career (indicative of 'good leaver' status and 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 'good leaver' status and discretion to release awards);
- departs at the request of and/or with the agreement of the Company (indicative of 'good leaver' status and discretion to release awards);
- resigns from the Company to work for a competitor or to undertake a role in conflict with the interests of 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).

In exercising its discretion, the Committee will also take into account the individual's overall performance as well as their contribution to the Company during their period of employment.

In addition, the Committee retains discretion to settle any other amounts reasonably due to an individual, for instance to meet the legal fees incurred by the Executive Director in connection with reviewing a settlement agreed on termination of employment, where the Company wishes to enter into a settlement agreement and the individual must obtain independent legal advice. If the Executive Director has relocated to take up the appointment, the Committee may also agree to meet the reasonable costs associated with returning the individual (and where relevant their family) to their country of origin and winding up their affairs in the UK, including the incidental costs incurred in doing so.

In certain circumstances, the Committee may approve new contractual arrangements with departing executives, potentially including (but not limited to) settlement, confidentiality, restrictive covenants and/or consultancy arrangements. Such arrangements would only be entered into where the Committee believes that it is in the best interests of the Company and its shareholders to do so.

Remuneration Report
Policy Report continued

Statement of consideration of employment conditions elsewhere in the Company

The Remuneration Committee does not consult directly with employees on the Directors' remuneration policy. The Committee does consider the budgeted salary increases for the employee population and remuneration arrangements and employment conditions for all employees, when determining the remuneration policy for the Executive Directors.

The Committee invites the Group Human Resources Director to present annually on the proposed average salary increases for the UK employee population and on any other significant changes to employee remuneration policy within the Company. The Committee expects that future salary increases for Executive Directors will be in line with the salary review guidelines applicable for the general UK employed population, except in those exceptional circumstances, such as where a recently appointed Executive Director's salary is increased to reflect his or her growth in the role over time or where significant additional responsibilities are added to the role. Annual bonus metrics and related targets for the Executive Directors are aligned with those of senior management and are cascaded to lower tier bonus plans, in order to maintain alignment and line of sight.

The Company will continue to include general questions on its pay arrangements, within its employee opinion survey. This is conducted every two years and the outcomes are reviewed by the Board.

Non-Executive Directors – remuneration policy

Background

The Company looks to recruit, as Non-Executive Directors, those who have a wide range of strategic and operational experience in other businesses or organisations, usually in an international context. A Non-Executive Director is required, as a minimum, to make an annual time commitment of about 30 days and is expected to attend all Board and Committee meetings as well as maintaining an appropriate level of knowledge about the business and its operations. Fees for Non-Executive Directors need to be sufficient to attract, motivate and retain individuals with the skills and senior-level experience required to drive the Company's strategy forward but no sign-on payments are offered.

Fees – process

As a UK-listed entity, the quantum and structure of Non-Executive Directors' remuneration will primarily be assessed against the same remuneration comparator group of companies used for setting the remuneration of Executive Directors (see note 1, page 72). The Board may also make reference to and take account of relevant research and analysis on non-executive directors' fees in FTSE 100 companies published by remuneration consultants from time to time. The fees for the Non-Executive Directors are reviewed annually, although the review does not always result in an increase in the Board fees or Committee fees.

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.

The current fees for the Non-Executive Directors for the year ending 31 December 2014 are:

Non-Executive Directors – fee structure	Fees from 1 Jan 2014 to 31 Dec 2014 £
Basic fee	**90,000**
Supplements:	
– Senior Independent Director	30,000
– Audit Committee Chairman	30,000
– CSR Committee Chairman	25,000
– Nominations Committee Chairman	–
– Remuneration Committee Chairman	30,000
Committee Memberships Fees (not Chairman):	
– Audit Committee	6,000
– CSR Committee	6,000
– Nominations Committee	6,000
– Remuneration Committee	6,000

It is anticipated that any future aggregate increase to any of the above fees will be within the salary guidelines which govern the Company's annual salary reviews for UK-based staff and will not exceed the equivalent of 10% per annum in aggregate.

Travel and related expenses

Non-Executive Directors are generally reimbursed for the cost of travel and related expenses incurred by them as Directors of the Company in respect of attendance at Board, Committee and General meetings. In addition, it is the policy of the Board that the partners of the Executive Directors and Non-Executive Directors may, from time to time, accompany the Directors to overseas or UK-based Board meetings and otherwise at hospitality functions during the year. In the instances where such expenses are classified by HMRC as a benefit to the Director, it is also the practice of the Company to pay the tax which may be due on any such benefits. Non-Executive Directors are also eligible for general practitioner 'walk-in' medical services. They receive no other pay or benefits.

Shareholding requirements

The remuneration of Non-Executive Directors is paid in cash. There are no formal requirements or guidelines for the Non-Executive Directors to hold shares in the Company. However, Non-Executive Directors are encouraged to acquire a small interest during the initial years after their date of appointment. The Non-Executive Directors do not participate in the British American Tobacco share schemes, bonus schemes or incentive plans and are not members of any Group pension plan.

Terms of appointment and termination

The Non-Executive Directors do not have service contracts with the Company but instead have letters of appointment which are available for inspection at the Company's registered office. 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. 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. No amounts due to a Non-Executive Director are subject to any recovery or withholding arrangements.

Chairman – remuneration policy

Background

The Chairman is responsible for the leadership of the Board, ensuring its effectiveness and setting its agenda, and for facilitating the productive contribution of both Executive and Non-Executive Directors. He or she is also responsible for ensuring that the interests of the shareholders are safeguarded and is accountable to the Board for leading the direction of the Company's strategy and for the overall supervision of Group policies governing the conduct of the business. The quantum of fees payable to the Chairman is therefore set at the level commensurate to reward the individual's seniority, skills and experience.

Fee – process

The Remuneration Committee considers annually the fee payable to the Chairman. Given that the role of a chairman can vary considerably between companies and sectors, this process (using data from the FTSE 30 companies) takes into account the breadth of that role coupled with its associated levels of personal commitment and expertise in the overall context of international reach and the 'ambassadorial' aspect of the role. As Chairman, Richard Burrows, is expected to make an annual time commitment of about 100 days to cover the responsibilities of the role. The Chairman does not participate in any discussions on his level of remuneration.

The current fee for Richard Burrows for the year ending 31 December 2014 has been determined as follows.

	Fees from 1 Apr 2014 £
Richard Burrows (Chairman)	**632,400**

It is anticipated that any future aggregate increase to the above fee will be within the salary guidelines which govern the Company's annual salary reviews for UK-based staff and will not exceed the equivalent of 10% per annum.

Benefits, travel and related expenses

Richard Burrows is reimbursed for the cost of travel and related expenses incurred by him in respect of attendance at Board, Committee and General meetings including the cost of return airline tickets to London from his home in Ireland in connection with his duties as Chairman. He is also entitled to the use of a company driver; private medical insurance and personal accident insurance benefits; and general practitioner 'walk-in' medical services. In addition, Richard Burrows' spouse may, from time to time, accompany him to overseas or UK-based Board meetings and otherwise at hospitality functions during the year. Where any such reimbursements are classified by HMRC as a benefit to the Director, it is also the practice of the Company to pay any tax due.

Approach to remuneration of Chairman on recruitment

In appointing a new Chairman, the Committee will offer the components set out in respect of the current Chairman, as appropriate, and may also offer housing allowances for a limited period and other relocation benefits.

Terms of appointment and termination

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 his 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.

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.

Aggregate annual limit

The fees of the Chairman and the Non-Executive Directors are determined within the overall aggregate annual limit of £2,500,000 authorised by shareholders with reference to the Company's Articles of Association.

Remuneration Report
Annual Report on Remuneration

Remuneration Committee

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

Attendance at meetings in 2013

Name	Attended/Eligible to attend
Gerry Murphy	5/5
Ann Godbehere	5/5
Christine Morin-Postel	5/5
Kieran Poynter	5/5
Robert Lerwill	1/1
Anthony Ruys	1/1
Karen de Segundo	1/1
Sir Nicholas Scheele	1/1

Notes:
1. Karen de Segundo, Robert Lerwill, Anthony Ruys and Sir Nicholas Scheele all ceased to be members of the Remuneration Committee on 27 February 2013.
2. The Chairman and the Chief Executive are required to attend meetings to discuss the performance of Executive Directors and may attend other meetings by invitation. The Group Human Resources Director attends meetings and the Group Head of Reward and other senior management may also attend by invitation. Neither the Chairman nor any Executive Director plays any part in determining his own remuneration.
3. The Committee's remuneration consultants, Deloitte LLP, also attend meetings of the Committee.
4. The Company Secretary acts as the Secretary to the Remuneration Committee.
5. The Committee held five meetings in 2013, of which four were scheduled.

Role

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 and the Executive Directors, both on appointment and on review and, if appropriate, any compensation payment due on termination of appointment;
- the setting of targets applicable for the Company's performance-based variable reward schemes and determining achievement against those targets, exercising discretion where appropriate and as provided by the applicable scheme rules; and
- monitoring and advising the Board on any major changes to the policy on employee benefit structures for the British American Tobacco Group.

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

Introduction

This section of the Remuneration Report sets out the Company's remuneration of its Executive and Non-Executive Directors for the financial year ended 31 December 2013 – the Annual Report on Remuneration. This report will, together with the annual statement by Gerry Murphy as the Chairman of the Remuneration Committee, be proposed for an advisory vote by shareholders at the AGM on 30 April 2014. It has been prepared in accordance with the relevant provisions of the Companies Act 2006 and on the basis prescribed in The Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013 (the 'Regulations'). Where required, data has been audited by PricewaterhouseCoopers LLP and this is indicated appropriately.

The initial pages of this report set out the membership of the Remuneration Committee that considered the remuneration of Directors during the year ended 31 December 2013. Details of the advisers to the Committee are also given together with a summary of its key activities during the year. At the date of this report the Remuneration Committee comprises independent Non-Executive Directors of the Company as set out in the table opposite.

Remuneration Committee – Advisers

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 2013, both the Chief Executive and Chairman were consulted and invited to attend meetings of the Committee.

The Group Human Resources Director and Group Head of Reward, supported by the Company Secretary, provide advice, guidance and assistance to the Committee. In addition, the Committee was materially assisted in its work by the following external providers of consultancy and other services:

Adviser	Appointment details	Services provided to the Committee	Fees paid	Other services provided to the Company
Deloitte LLP	Letter of engagement for provision of services to the Committee	General advice on remuneration matters including: market trends and comparator group analysis; policy review and shareholder engagement perspectives; independent measurement of TSR performance conditions	2013: £214,846 (2012: £270,150)	Tax, corporate finance and consulting services to Group companies worldwide
Herbert Smith Freehills LLP	Corporate level engagement authorised by the Company Secretary	Advice on law and regulation in respect of share plan matters is provided to the Company and is available to the Committee	Legal fees relate to advice provided to the Company	General corporate legal and tax advice principally in the UK
Ernst & Young LLP	Engagement approved by the Group Human Resources Director	Provision of personal tax advice regarding Executive Directors' international pension planning	Fees relate to advice provided to the Company	Tax, corporate finance and consulting services to Group companies worldwide
PricewaterhouseCoopers LLP	Annual letter of engagement	Specified procedures to assist the Committee's assessment of the calculations used to determine IEIS bonus outcomes and future targets	2013: £10,560 (2012: £10,260)	External auditor; audit and tax services and other non-audit services

The Remuneration Committee has not expressly considered the objectivity and independence of the advice received from these professional firms. It does reflect upon the quality of the advice received and how this satisfactorily covers the matter under consideration as part of its normal deliberations. The Committee is confident that none of the cross-relationships generate an unmanageable conflict of interest and that the fees paid in respect of each service do not compromise the objectivity and impartiality of the provision of the other services.

Remuneration Report
Annual Report on Remuneration continued

Remuneration Committee – Activities in 2013

Regular work programme

February	– benchmarked, reviewed and set salaries for the Executive Directors from 1 April 2013 taking into account the pay employment conditions elsewhere in the Group, particularly in the UK	– determined the LTIP awards for March 2013 for the Executive Directors and the associated performance conditions
	– reviewed and set the Chairman's fee from 1 April 2013	– assessed the achievement of the targets for the 2012 Share Reward scheme and set the targets for the 2013 award
	– assessed the achievement of the targets for the 2012 IEIS award and set the IEIS targets for 2012	– monitored the continued application of the Company's shareholding guidelines for the Executive Directors
	– assessed the measurement of the performance conditions for the vesting of the LTIP 2010 award	– reviewed the Remuneration Report for the year ended 2012 prior to its approval by the Board and subsequent approval by shareholders at the AGM on 25 April 2013
July	– an analysis of the voting on the Company's Remuneration Report at the AGM on 25 April 2013	– the assessment of the performance measures for the six months to 30 June 2013 for the IEIS 2013 and the outstanding LTIP awards
October	– a preview of the likely market trends affecting the salary review for 2014 including a review of areas of concern for key shareholders	
December	– a review of the report on the effectiveness of the Remuneration Committee	

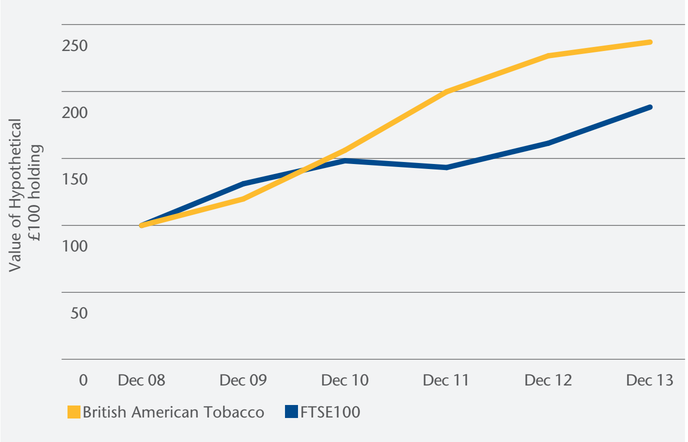
Remuneration policy review

February	– consideration of an overview of remuneration policy areas subject to review in 2013	– a timetable for engagement with shareholders in light of the proposed changes to the executive remuneration policy
	– a presentation of the outcomes of the detailed review and benchmarking for executive remuneration together with initial recommendations for changes to the policy (focusing on variable pay) to be proposed to shareholders	
October	– an update on the remuneration policy review and progress on the consultation process with shareholders	
November	– consideration and approval of amendments to the remuneration policy as a result of the shareholder consultation process	
December	– agreement on the final details of the revised remuneration policy to apply to the Executive Directors with effect from 1 January 2014	

Other incentive matters

February	– approval of the continuation of private medical insurance for the Chief Executive in both Brazil and the UK	– a review of the Group's global mobility and localisation policies with particular reference to international assignees
July	– approval of the date of retirement and associated arrangements (in principle) for the Chief Operating Officer	– consideration of the impact of the UK lifetime pension allowance on overseas pensions arrangements with specific reference to the approval of the payment of the tax liability on a grossed-up basis in respect of the Chief Executive's former pension accrual under the FASC
December	– a review of summary guidance on remuneration matters and voting and related guidelines published by shareholder representative bodies	– an outline of the principal regulatory requirements for disclosures in the Annual Report on Remuneration

Performance and pay – 2009 to 2013



This chart shows the performance of a hypothetical investment of £100 in the Company's shares (as measured by the total shareholder return (TSR) for the Company) against a broad equity market index (the FTSE 100 Index) over a period of five financial years starting from 1 January 2009 through to 31 December 2013, based on 30 trading day average values.

TSR measurement

TSR is measured according to the return index calculated by Datastream and reviewed by the Company's remuneration consultants. It is measured on the basis that all the Company's dividends are reinvested in the Company's shares. The return is the percentage increase in the Company's index over the five-year period. A local currency basis is used for the purposes of the TSR calculation, making it consistent with the approach to TSR measurement for the LTIP.

FTSE 100 Index

The Directors consider that the FTSE 100 Index is the most appropriate index against which TSR should be measured for this disclosure because it is a widely used and understood index.

Chief Executive's pay

The pay for the Chief Executive (CEO) for each of the financial years ended 2009 to 2013 is set out below for comparative purposes:

Year	2009	2010	2011	2012	2013
CEO 'single figure' of total remuneration (£'000)					
Paul Adams[1] (to 28 Feb 2011)	7,713	8,858	5,961	N/A	**N/A**
Nicandro Durante[2] (from 1 Mar 2011)	N/A	N/A	5,589	6,340	**6,492**
Annual bonus (IEIS) paid against maximum opportunity (%)					
Paul Adams[1] (to 28 Feb 2011)	67.7	87.0	100	N/A	**N/A**
Nicandro Durante[2] (from 1 Mar 2011)	N/A	N/A	100	85.0	**81.3**
Long-term incentive (LTIP) paid against maximum opportunity (%)					
Paul Adams[1] (to 28 Feb 2011)	100	100	100	N/A	**N/A**
Nicandro Durante[2] (from 1 Mar 2011)	N/A	N/A	100	87.1	**49.2**

Notes:

1. Paul Adams: (a) historic data is taken from the remuneration reports for the relevant years, but recast (as appropriate) on the basis of the 'single figure' calculation as prescribed in the Regulations; (b) he retired as Chief Executive on 28 February 2011 which affected his short-term (annual bonus – IEIS) and long-term incentives (LTIP) as follows in accordance with the rules of those schemes: (i) his performance-related bonus (IEIS) for the year ended 31 December 2010 was paid as a 100% cash bonus instead of 50% in cash and 50% in deferred shares; (ii) the outstanding LTIP awards of shares vested immediately on his retirement either in full (2008 Award) or on a pro-rated basis (2009 Award and 2010 Award); and (iii) the LTIP dividend equivalent payments for the LTIP awards which vested at his retirement were also paid in full and/or on a pro-rated time and performance basis.
2. Nicandro Durante: (a) historic data is taken from the remuneration reports for the relevant years, but recast (as appropriate) on the basis of the 'single figure' calculation as prescribed in the Regulations; and (b) he became Chief Executive on 1 March 2011 and his 'single figure' remuneration for the year ended 31 December 2011 has accordingly been time apportioned.

Remuneration Report
Annual Report on Remuneration continued

Relative importance of spend on pay

To illustrate the relative importance of the remuneration of the Directors in the context of the Group's finances overall, the Remuneration Committee makes the following disclosure:

Item	2013 £m	2012 £m
Remuneration of Group employees[1]	**2,384**	2,426
– Remuneration of Executive Directors	**14**	15
– Remuneration of Chairman and Non-Executive Directors	**2**	2
Dividends paid in the year	**2,611**	2,538
Share buy-back programme	**1,500**	1,250
Adjusted profit from operations[2]	**5,820**	5,641

Notes:

1. The total remuneration of Group employees has changed in the year mainly as a result of local remuneration agreements, varying employment costs across end markets and regions; and the impact of exchange rate movements.

2. Adjusted profit from operations: this is the adjusted profit from operations of the Group's subsidiaries at constant rates of exchange for the items shown as memorandum information in the Group Income Statement. It has been chosen as a benchmark for this disclosure given its linkage to the short-term incentive element of remuneration as one of the four performance measures under the IEIS.

Directors' remuneration for the year ended 31 December 2013

Single total figures for Directors' remuneration
Executive Directors: Aggregate – audited

The following table shows a single figure of remuneration for the Executive Directors in respect of qualifying services for the year ended 31 December 2013 together with comparative figures for 2012. Some data from the 2012 remuneration report has been recast (as appropriate) on the basis of the 'single figure' calculations in the Regulations. The aggregate directors' emoluments are shown at page 97. Details of the fees for the Chairman and the Non-Executive Directors are set out in separate tables below.

Single total figures for Executive Directors	Salary £'000		Taxable benefits £'000		Short-term incentives £'000		Long-term incentives £'000		Pension £'000		Other emoluments[1] £'000		Total remuneration £'000	
	2013	2012	**2013**	2012	**2013**	2012	**2013**	2012	**2013**	2012	**2013**	2012	**2013**	2012
Nicandro Durante	**1,088**	1,038	**626**	178	**1,790**	1,786	**2,380**	2,201	**307**	734	**301**	403	**6,492**	6,340
Ben Stevens	**808**	774	**100**	109	**1,196**	1,198	**1,285**	2,062	**607**	579	**270**	353	**4,266**	5,075
John Daly	**713**	680	**104**	109	**1,056**	1,056	**1,160**	1,150	**480**	439	**169**	215	**3,682**	3,649
Total	**2,609**	2,492	**830**	396	**4,042**	4,040	**4,825**	5,413	**1,394**	1,752	**740**	971	**14,440**	15,064

Note:

1. Other emoluments – these include: (1) life insurance; (2) cash dividend equivalent payments made under the LTIP and DSBS; and (3) the value of shares received under the Share Reward Scheme during the year.

Analysis by individual Director – audited

Nicandro Durante

	2013 **£'000**	2012 £'000
Salary	**1,088**	1,038
Taxable benefits[1]		
Cash:		
– car allowance	**16**	16
Non-cash:		
– health insurance/provision of 'walk-in' health care services	**7**	3
– tax advice	**36**	6
– tax equalisation payment re tax charge for FASC pension accrual[2]	**440**	–
– the use of a company driver	**64**	65
– travel and related costs in respect of relocation from Brazil	**–**	14
– employee welfare and medical payments in Brazil[3]	**37**	52
– maintenance of home security systems in the UK and Brazil	**19**	9
– other expenses incurred in connection with individual and/or accompanied attendance at certain business functions and/or corporate events	**7**	13
Total taxable benefits	**626**	178
Short-term incentives		
– annual performance-related bonus: IEIS – cash receivable Mar 2014 (YE 2013)	**895**	
– annual performance-related bonus: DSBS – award of deferred shares to this value Mar 2014 (YE 2013)	**895**	
– annual performance-related bonus: IEIS – cash received Mar 2013 (YE 2012)		893
– annual performance-related bonus: DSBS – award of deferred shares to this value Mar 2013 (YE 2012)		893
Total short-term incentives	**1,790**	1,786
Long-term incentives		
LTIP: award 13 May 2011 of 147,329 shares; performance period 2011/2013; award will vest on 13 May 2014 at 49.2% resulting in 72,485 shares; estimated value shown for the purposes of this disclosure based on the average share price for the last three months for the year ended 31 Dec 2013 of 3,283.44p	**2,380**	
LTIP: award 25 Mar 2010 of 69,751 shares; performance period 2010/2012; award vested on 25 Mar 2013 at 87.1% resulting in 60,753 shares and was exercised on 25 Apr 2013 at an execution price of 3,623.29p per share		2,201
Total long-term incentives	**2,380**	2,201
Pension-related benefits		
Fundacao Albino Souza Cruz (FASC – Brazil)[4]	**–**	455
Unfunded unapproved retirement benefit scheme (UURBS – UK)[5]	**307**	279
Total pension-related benefits	**307**	734
Other emoluments		
Life insurance	**15**	13
Cash dividend equivalent (DSBS): cash sums equivalent to the dividend on the after-tax position on all unvested ordinary shares comprised in the share awards held by the participant in the DSBS at each dividend record date	**55**	45
Cash dividend equivalent (LTIP): a cash sum equivalent to the aggregated dividends that an LTIP participant would have received as a shareholder over the 3-year period on the actual number of shares that vest under an LTIP award	**228**	323
Share Reward Scheme: value of shares received during the year	**3**	3
Sharesave Scheme: grant of options on 28 Mar 2012 over 591 shares at an option price of 2,536p per share; options were awarded at a discount of 20% of the market value (3,170p per share) in accordance with the rules of the Sharesave Scheme	**–**	19
Total other emoluments	**301**	403

Notes:

1. The figures shown for benefits are gross amounts as it is the normal practice of the Company to pay the tax which may be due on any benefits, with the exception of the car or car allowance.
2. Tax equalisation payment: this is in respect of the tax charge arising from the FASC pension accrual in excess of the UK-regulated annual allowance and is met by a single one-off gross payment by the Company.
3. Employee welfare medical payments in Brazil: Nicandro Durante retained certain termination or compensation rights in respect of his former employment with Souza Cruz SA until 2 April 2012, outstanding welfare payments were made in 2013.
4. FASC pension-related benefits: these have been in payment since 1 April 2012; refer to 'Total Pension Entitlements' below.
5. UURBS pension-related benefits represent the individual's accrual for the period (net of inflation) as measured by the retail prices index at September 2013, multiplied by 20 in accordance with the Regulations.
6. Nicandro Durante was appointed non-executive director of Reckitt Benckiser Group plc on 1 December 2013. He retains the fees for this appointment 2013: £7,083 (2012: £nil).

Remuneration Report
Annual Report on Remuneration continued

Ben Stevens

	2013 £'000	2012 £'000
Salary	**808**	774
Taxable benefits[1]		
Cash:		
– car allowance	**14**	14
Non-cash:		
– health insurance/provision of 'walk-in' health care services	**4**	3
– the use of a company driver	**74**	78
– maintenance of home security systems in the UK	**3**	4
– other expenses incurred in connection with individual and/or accompanied attendance at certain business functions and/or corporate events	**5**	10
Total taxable benefits	**100**	109
Short-term incentives		
– annual performance-related bonus: IEIS – cash receivable Mar 2014 (YE 2013)	**598**	
– annual performance-related bonus: DSBS – award of deferred shares to this value Mar 2014 (YE 2013)	**598**	
– annual performance-related bonus: IEIS – cash received Mar 2013 (YE 2012)		599
– annual performance-related bonus: DSBS – award of deferred shares to this value Mar 2013 (YE 2012)		599
Total short-term incentives	**1,196**	1,198
Long-term incentives		
LTIP: award 13 May 2011 of 79,558 shares; performance period 2011/2013; award will vest on 13 May 2014 at 49.2% resulting in 39,142 shares; estimated value shown for the purposes of this disclosure based on the average share price for the last three months for the year ended 31 Dec 2013 of 3,283.44p	**1,285**	
LTIP: award 25 Mar 2010 of 65,323 shares; performance period 2010/2012; award vested on 25 Mar 2013 at 87.1% resulting in 56,896 shares and was exercised on 25 Apr 2013 at an execution price of 3,624.35p per share		2,062
Total long-term incentives	**1,285**	2,062
Pension-related benefits[2]		
British American Tobacco UK Pension Fund	**28**	16
Unfunded unapproved retirement benefit scheme (UURBS – UK)	**579**	563
Total pension-related benefits	**607**	579
Other emoluments		
Life insurance	**7**	6
Cash dividend equivalent (DSBS): cash sums equivalent to the dividend on the after-tax position on all unvested ordinary shares comprised in the share awards held by the participant in the DSBS at each dividend record date	**46**	42
Cash dividend equivalent (LTIP): a cash sum equivalent to the aggregated dividends that an LTIP participant would have received as a shareholder over the 3-year period on the actual number of shares that vest under an LTIP award	**214**	302
Share Reward Scheme: value of shares received during the year	**3**	3
Total other emoluments	**270**	353

Notes:
1. The figures shown for benefits are gross amounts as it is the normal practice of the Company to pay the tax which may be due on any benefits, with the exception of the car or car allowance.
2. Pension-related benefits represent the individual's accrual for the period (net of inflation) as measured by the retail prices index as at September 2013, multiplied by 20 in accordance with the Regulations.

John Daly

	2013 £'000	2012 £'000
Salary	**713**	680
Taxable benefits[1]		
Cash:		
– car allowance	**14**	14
Non-cash:		
– health insurance/provision of 'walk-in' health care services	**5**	3
– tax advice	**–**	4
– the use of a company driver	**75**	75
– maintenance of home security systems in the UK	**8**	7
– other expenses incurred in connection with individual and/or accompanied attendance at certain business functions and/or corporate events	**2**	6
Total taxable benefits	**104**	109
Short-term incentives		
– annual performance-related bonus: IEIS – cash receivable Mar 2014 (YE 2013)	**528**	
– annual performance-related bonus: DSBS – award of deferred shares to this value March 2014 (YE 2013)	**528**	
– annual performance-related bonus: IEIS – cash received Mar 2013 (YE 2012)		528
– annual performance-related bonus: DSBS – award of deferred shares to this value Mar 2013 (YE 2012)		528
Total short-term incentives	**1,056**	1,056
Long-term incentives		
LTIP: award 13 May 2011 of 71,823 shares; performance period 2011/2013; award will vest on 13 May 2014 at 49.2% resulting in 35,336 shares; estimated value shown for the purposes of this disclosure based on the average share price for the last three months for the year ended 31 Dec 2013 of 3,283.44p	**1,160**	
LTIP: award 25 Mar 2010 of 37,643 shares; performance period 2010/2012; award vested on 25 Mar 2013 at 87.1% resulting in 32,787 shares; these shares were exercised on 25 Mar 2013 and the holding was retained; an estimated value for the purposes of this disclosure is based on a share price of 3,509p per share at the date of vesting and exercise, 25 Mar 2013		1,150
Total long-term incentives	**1,160**	1,150
Pension-related benefits[2]		
British American Tobacco UK Pension Fund	**86**	95
Unfunded unapproved retirement benefit scheme (UURBS – UK)	**394**	344
Total pension-related benefits	**480**	439
Other emoluments		
Life insurance	**8**	7
Cash dividend equivalent (DSBS): cash sums equivalent to the dividend on the after-tax position on all unvested ordinary shares comprised in the share awards held by the participant in the DSBS at each dividend record date	**35**	28
Cash dividend equivalent (LTIP): a cash sum equivalent to the aggregated dividends that an LTIP participant would have received as a shareholder over the 3-year period on the actual number of shares that vest under an LTIP award	**123**	177
Share Reward Scheme: value of shares received during the year	**3**	3
Total other emoluments	**169**	215

Notes:

1. The figures shown for benefits are gross amounts as it is the normal practice of the Company to pay the tax which may be due on any benefits, with the exception of the car or car allowance.
2. Pension-related benefits represent the individual's accrual for the period (net of inflation) as measured by the retail prices index as at September 2013, multiplied by 20 in accordance with the Regulations. John Daly ceased accrual in the PJ Carroll Directors' Plan with effect from 31 August 2004.
3. John Daly is also 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 and Williamson Holdings, Inc (a wholly-owned indirect subsidiary of the Company), as its nominee to sit on the board of RAI (a BAT Designee). In accordance with present arrangements, the Group received a fee of US$277,284 from RAI (2012: US$271,980) in respect of John Daly's service in that role for the year ended 31 December 2013. Following his retirement as an Executive Director on 6 April 2014, John Daly will remain a BAT Designee from that date and will receive an annual fee from RAI for these services.

Remuneration Report
Annual Report on Remuneration continued

Base salary

The process of the annual salary review for the Executive Directors took place in February 2013 with the following changes effective from 1 April 2013. The basis for the salary review is stated in the policy table (see page 65). UK-based employees received salary increases averaging around 3.5% with effect from 1 April 2013.

Executive Directors – salaries	Base salary from 1 Apr 2013 £	Percentage change %	Base salary from 1 Apr 2012 £
Nicandro Durante	**1,100,000**	4.76	1,050,000
Ben Stevens	**817,000**	4.48	782,000
John Daly	**721,000**	4.49	690,000

Additional requirements in respect of the single total figure table

This section sets out supporting information and details for the single total figure for remuneration for the Executive Directors with particular reference to the determination of the performance conditions for the annual IEIS short-term incentive payments; the extent to which three-year performance conditions have been satisfied for the LTIP; and more detailed narrative on pension entitlements.

Short-term incentives: International Executive Incentive Scheme (IEIS) – audited

Annual awards under the IEIS are earned by reference to the financial year and are paid in March following the end of the financial year. These variable performance-related awards are delivered 50% in cash and 50% in shares (deferred shares through the Deferred Share Bonus Scheme – DSBS). No element of the bonus is guaranteed.

The performance under the IEIS is reviewed by the Remuneration Committee in February each year on the basis of an internal report supplemented by specific procedures provided by the Group's external auditors to assist the Committee's assessment of the relevant calculations. The total payout is determined by the Company's performance for each measure relative to that measure's performance points. The Committee retains discretion to override that payout in circumstances where, in its judgement, the overall performance of the Company justifies a different outcome whether higher or lower than that determined by the application of the bonus formula.

In presenting the outcomes for the year, the Remuneration Committee considers the commercial confidentiality and sensitivity of the performance measures and associated targets and results. This is done in the context of the Company operating in a highly consolidated industry where key competitors are not subject to the same regulatory disclosures and who could gain advantageous insights if actual targets were disclosed year on year. Consequently, the ranges of indicative performance only will be disclosed in respect of the financial year completed. The Committee will review the commercial confidentiality of the targets on an annual basis.

The ranges of indicative performance for the year ended 31 December 2013 are set out below.

IEIS: performance measure	Year KPI	Weighting %	Threshold	Target	Maximum	Actual performance
Adjusted profit from operations (growth over prior year)	**2013**	**40**			→	**+7%**
	2012	40			→	+8%

The measure for 2013

Profit used in this assessment is the adjusted profit from operations of the Group's subsidiaries. This is the profit from operations at budget rates of exchange adjusted for the items shown as memorandum information in the Group Income Statement. It is the Group's medium to long-term aim to grow adjusted profit from operations on average by 6% annually.

Performance for 2013

The Group has seen another significant improvement in its adjusted operating margin by 100 basis points in 2013, at the top end of the target range of increasing operating margin by 50 to 100 basis points each year. This was achieved due to efforts across the global organisation to address the cost base, to standardise systems and to deliver productivity savings year on year. A strong price mix of effect 7% also contributed to the result.

IEIS: performance measure	Year KPI	Weighting %	Threshold	Target	Maximum	Actual performance
Increase in the Group's share of key markets (growth over prior year)	**2013**	**20**	—	—	→	**+0.2%**
	2012	20	—	→		+0.1%

The measure for 2013

This measure is the Group's retail market share in its key markets which account for around 80% of the volumes of the Group's subsidiaries. The aim is to increase the Group's share year on year. The information used in this calculation is based on data supplied by subscription-based retail audit service providers. The process is subject to rebasing as and when the Group's key markets change: the retail audit provider will occasionally amend the panel of representative outlets which is used to approximate the total market in any given territory. This can cause changes in the actual market share reported for all competitors. The changes rarely result in any adjustment to the growth or decline in share between the two periods. When rebasing does occur, the Company will also restate history and provide fresh comparative data on the markets.

Performance for 2013

Global market share in key markets grew by 20 basis points, driven by the success of the GDBs which were up by 60 basis points. The Group's share of the premium segment also grew, up by 80 basis points.

IEIS: performance measure	Year KPI	Weighting %	Threshold	Target	Maximum	Actual performance
Global Drive Brand (GDBs) volumes (growth over prior year)	**2013**	**20**	→			**+2.1%**
	2012	20	—	→		+3.0%

The measure for 2013

Global Drive Brand volumes comprise the cigarette volumes of the following GDB brands sold by the Group's subsidiaries: Dunhill, Kent, Lucky Strike and Pall Mall and include volumes of the Fine Cut variants of those brands sold in Western Europe.

The aim is to improve the quality of the Group's portfolio by increasing the volume of GDBs faster than the rest of the brands in the Group's portfolio.

Performance for 2013

GDB volumes (as defined above) grew by 2.1% in 2013, with their overall cigarette market share growing strongly in the Group's key markets by 60 basis points.

IEIS: performance measure	Year KPI	Weighting %	Threshold	Target	Maximum	Actual performance
Cash flow from operations (as against budget)	**2013**	**20**	—	—	→	**+10%**
	2012	20	—	—	→	+14%

The measure for 2013

Cash flow from operations is defined as the free cash flow excluding restructuring costs, dividends and other appropriations from associate undertakings as referenced to the cash flow and net debt movements. The aim is to generate the optimal level cash flow while continuing to invest to support the short, medium and long-term requirements of the business.

Performance for 2013

The improvement in cash flow from operations reflected the growth in underlying operating performance and the decrease in net capital expenditure, partially offset by working capital movements.

Remuneration Report
Annual Report on Remuneration continued

The total payouts for the Executive Directors (expressed as a percentage of base salary) are shown below with the actual payments shown in the individual analysis tables on pages 85–87.

IEIS payout: **50% in cash, 50% in deferred shares**	**2013 %**	**Maximum opportunity %**	2012 %	Maximum opportunity %
Nicandro Durante	**162.7**	**200**	170.1	200
Ben Stevens	**146.4**	**180**	153.1	180
John Daly	**146.4**	**180**	153.1	180

The awards made under the DSBS are in the form of free ordinary shares in the Company that are normally held in trust for three years and no further performance conditions apply in that period. In certain circumstances, such as resigning before the end of the three-year period, participants may forfeit all of the shares. Further, for DSBS awards made on or after March 2014, the Company may determine to reduce or lapse an award of shares in its entirety if it has been found that a participant has materially misrepresented his or her own performance and/or that of the Company in respect of the basis upon which the award of DSBS shares was originally made.

Long-term incentives: Long-Term Incentive Plan (LTIP) – audited

The Remuneration Committee sets out the following additional details for LTIP.

Performance against performance targets for vesting for the LTIP

The LTIP amount included in the 2013 single figure of remuneration is the LTIP award of conditional shares granted to Executive Directors on 13 May 2011 (the 2011 LTIP Awards). Vesting was dependent on: (1) performance over the three financial years ended 31 December 2013; and (2) the LTIP participant remaining a Director/employee at the anniversary of the allocation or award date, subject to the number of award shares to be exercised being pro-rated (as applicable) in the instance of a departing executive.

2011 LTIP Awards

Performance measure	Threshold	Maximum	Actual	Percentage of maximum achieved %
Total shareholder return (TSR) ranking – the constituents of the London Stock Exchange FTSE 100 Index at the beginning of the performance period (1 Jan 2011 to 31 Dec 2013): 25% of award	Median (6% of award vests)	Upper quartile (25% of award vests)	Ranked 34/97	**17.9**
Total shareholder return (TSR) ranking – a peer group of international FMCG companies at the beginning of the performance period (1 Jan 2011 to 31 Dec 2013): 25% of award	Median (6% of award vests)	Upper quartile (25% of award vests)	Ranked 10/24	**14.2**
Earnings per share – growth relative to inflation: 50% of award	3%	8%	4.1%	**17.1**
Total				**49.2**

Notes:
1. TSR – FTSE 100 comparator group: the comparison is based on three months' average values and the Company achieved an above median annualised TSR of 15.6%. Three companies in the comparator group delisted during the performance period.
2. TSR – FMCG comparator group: the comparison is based on three months' average values and the Company achieved an above median annualised TSR of 15.6%. Two companies in the comparator group of 26 entities delisted during the performance period.

The 2011 LTIP awards had not vested at the date of this report. The average share price for the last three months of the financial year has been used to determine the value of the 2011 awards for the purposes of the single total figure. The awards held by the Executive Directors were as below.

2011 LTIP awards	Number of shares awarded	Number of shares vesting Percentage vesting	Shares lapsing Percentage lapsing	Value of shares vesting for YE 2013 £'000[1]
Performance period: 1 Jan 2011 – 31 Dec 2013 Award date: 13 May 2011 Vesting date: 13 May 2014				
Nicandro Durante	147,329	72,485 49.2%	74,844 50.8%	**2,380**
Ben Stevens	79,558	39,142 49.2%	40,416 50.8%	**1,285**
John Daly	71,823	35,336 49.2%	36,487 50.8%	**1,160**

Note:
1. The average share price for the last three months for the year ended 31 December 2013 was 3,283.44p.

Current position on outstanding LTIP awards

The tables below show the current position against the performance targets for the LTIP awards outstanding for Executive Directors as at 31 December 2013.

2012 LTIP awards

Performance measure	Threshold	Maximum	Actual to 31 Dec 2013	Current percentage achieved at 31 Dec 2013 %
Total shareholder return (TSR) ranking – the constituents of the London Stock Exchange FTSE 100 Index at the beginning of the performance period (1 Jan 2012 to 31 Dec 2014): 25% of award	Median (6% of award vests)	Upper quartile (25% of award vests)	Ranked 66/97	**0.0**
Total shareholder return (TSR) ranking – a peer group of international FMCG companies at the beginning of the performance period (1 Jan 2012 to 31 Dec 2014): 25% of award	Median (6% of award vests)	Upper quartile (25% of award vests)	Ranked 22/24	**0.0**
Earnings per share – growth relative to inflation: 50% of award	3%	8%	1.1%	**0.0**
Total				**0.0**

Notes:
1. TSR – FTSE 100 comparator group: the comparison is based on three months' average values and the Company achieved a below median annualised TSR of 10.7% for the interim testing period. Three companies in the comparator group have delisted during the performance period to date, 31 December 2013.
2. TSR – FMCG comparator group: the comparison is based on three months' average values and the Company achieved a below median annualised TSR of 10.7% for the interim testing period. Two companies in the comparator group of 26 entities have delisted during the performance period to date, 31 December 2013.

Remuneration Report
Annual Report on Remuneration continued

2013 LTIP awards

Performance measure	Threshold	Maximum	Actual to 31 Dec 2013	Current percentage achieved at 31 Dec 2013 %
Total shareholder return (TSR) ranking – the constituents of the London Stock Exchange FTSE 100 Index at the beginning of the performance period (1 Jan 2013 to 31 Dec 2015): 25% of award	Median (6% of award vests)	Upper quartile (25% of award vests)	Ranked 72/98	**0.0**
Total shareholder return (TSR) ranking – a peer group of international FMCG companies at the beginning of the performance period (1 Jan 2013 to 31 Dec 2015): 25% of award	Median (6% of award vests)	Upper quartile (25% of award vests)	Ranked 20/24	**0.0**
Earnings per share – growth relative to inflation: 50% of award	3%	8%	1.7%	**0.0**
Total				**0.0**

Notes:
1. TSR – FTSE 100 comparator group: the comparison is based on three months' average values and the Company achieved a below median annualised TSR of 6.9% for the interim testing period. Two companies in the comparator group have delisted during the performance period to date, 31 December 2013.
2. TSR – FMCG comparator group: the comparison is based on three months' average values and the Company achieved a below median annualised TSR of 6.9% for the interim testing period. Two companies in the comparator group of 26 entities have delisted during the performance period to date, 31 December 2013.

Vesting of past LTIP awards for the years ended 2009 to 2013

The following table shows the historical vesting of awards over the five-year period for the years ended 31 December 2009 to 31 December 2013, inclusive.

LTIP award date	**13 May 2011**	25 Mar 2010	27 Mar 2009	15 May 2008	15 May 2007
Year ended	**31 Dec 2013**	31 Dec 2012	31 Dec 2011	31 Dec 2010	31 Dec 2009
Performance period	**2011/2013**	2010/2012	2009/2011	2008/2010	2007/2009
Vesting date	**13 May 2014**	25 Mar 2013	27 Mar 2012	15 May 2011	15 May 2010
TSR – FTSE 100 group of companies:					
Ranking	**34**	15	21	12	8
Percentage of vesting award	**17.9**	25	25	25	25
TSR – FMCG peer group:					
Ranking	**10**	5	5	2	2
Percentage of award vesting	**14.2**	25	25	25	25
Earnings per share growth:					
Percentage per annum above inflation	**4.1**	6.5	10.8	15.9	12.1
Percentage of vesting award	**17.1**	37.1	50	50	50
Total vesting percentage	**49.2**	87.1	100	100	100

TSR performance condition – LTIP awards to 2013

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 the comparator groups, 50% of the total award vests in full; 6% of the total award vest for median performance. There is a pro rata vesting between these two points. The TSR portions of an LTIP award do not vest for below median performance.

Comparator group

The comparator group, which is regularly reviewed to ensure that it remains both relevant and representative, is chosen to reflect the Company's financial and business trading environments.

As at 31 December 2013, the constituents of the comparator group for the 2011, 2012 and 2013 LTIP Awards were as set out below.

FMCG peer group

Anheuser-Busch InBev
Campbell Soup
Carlsberg
Coca-Cola
Colgate-Palmolive
Danone
Diageo
Heineken
Imperial Tobacco Group
Japan Tobacco
Johnson & Johnson
Kellogg
Kimberley-Clark
Mondelez International
LVMH
Nestlé
PepsiCo
Pernod Ricard
Philip Morris International
Procter & Gamble
Reckitt Benckiser
SAB Miller
Unilever

Measurement of TSR

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

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

EPS performance condition – LTIP awards to 2013

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

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.

LTIP – malus provision

The rules of the LTIP give the Remuneration Committee the discretion to reduce (or forfeit entirely) a participant's unvested award. This would be considered in circumstances where there had been a material misrepresentation involving the participant in connection with a prior vested award.

All-employee share schemes

The Company operates the following all-employee share schemes in which the Executive Directors participate, as shown as at 31 December 2013.

Executive Directors	Nicandro Durante	Ben Stevens	John Daly
All-employee share schemes:			
Sharesave Scheme	✓	✓	✓
Share Incentive Plan (Partnership Scheme)	✓		
Share Incentive Plan (Share Reward Scheme/International Share Reward Scheme)	✓	✓	✓

Remuneration Report
Annual Report on Remuneration continued

Percentage change in the Chief Executive's remuneration

The table below shows the percentage change in salary, taxable benefits and short-term incentives (bonus) of the Chief Executive between the years ended 31 December 2012 and 31 December 2013 compared with the average of each of those components of remuneration over the same period for UK Senior Management (defined below), that being the chosen comparator group of employees in the British American Tobacco group.

	Base salary			Taxable benefits			Short-term incentives		
		£'000	Increase %		£'000	Increase %		£'000	Increase/ Decrease %
	2013	2012		**2013**	2012		**2013**	2012	
Nicandro Durante (Chief Executive)	**1,088**	1,038	4.82	**186**[2]	178	4.49	**1,790**	1,786	0.22
UK Senior Management[1]	**208**	201	3.50	**14**	14	–	**147**	172	(14)

Notes:

1. UK Senior Management: this group is a particularly relevant hierarchy of employees in the UK in terms of succession planning and management reporting, being the top 80 individuals who operate immediately below and principally report to the Management Board. This group of individuals, like the Executive Directors, tend to be on UK-based contracts and are eligible to participate in the short-term incentive arrangements.
2. Taxable benefits: in order to provide a relevant comparative figure, the one-off tax equalisation payment of £440,000 made in 2013 has been excluded.

Single total figures for Directors' remuneration

Non-Executive Directors: Aggregate – audited

The following table shows a single figure of remuneration for the Non-Executive Directors in respect of qualifying services for the year ended 31 December 2013 together with comparative figures for 2012. The aggregate directors' emoluments are shown on page 97.

Non-Executive Directors	Board fees £'000		Other fees £'000		Taxable benefits[1] £'000		Total remuneration £'000	
	2013	2012	**2013**	2012	**2013**	2012	**2013**	2012
Karen de Segundo Chair: CSR Committee	**90**	90	**26**	28	**1**	–	**117**	118
Ann Godbehere Member: Audit Committee Member: Remuneration Committee	**90**	90	**13**	10	**1**	2	**104**	102
Christine Morin-Postel Senior Independent Director Member: CSR Committee Member: Remuneration Committee	**90**	90	**33**	9	**9**	3	**132**	102
Gerry Murphy Chairman: Remuneration Committee	**90**	90	**30**	22	**1**	1	**121**	113
Kieran Poynter Chairman: Audit Committee Member: Remuneration Committee	**90**	90	**29**	10	**–**	–	**119**	100
Anthony Ruys Member: Audit Committee	**90**	90	**7**	17	**14**	7	**111**	114
Richard Tubb (from 28 Jan 2013) Member: CSR Committee	**84**	N/A	**6**	N/A	**54**	N/A	**144**	N/A
Retired Non-Executive Directors								
Robert Lerwill (to 25 Apr 2013) Chairman: Audit Committee	**29**	90	**11**	33	**3**	5	**43**	128
Sir Nicholas Scheele (to 25 Apr 2013) Senior Independent Director Member: CSR Committee	**29**	90	**13**	38	**81**	52	**123**	180
Total	**682**	720	**168**	167	**164**	70	**1,014**	957

Notes:

1. The figures shown for benefits are gross amounts, as appropriate, and it is the normal practice of the Company to pay the tax which may be due on any benefits.
2. The Non-Executive Directors' taxable benefits for 2012 have been restated where appropriate following the individual apportionment of travel expenses, as required under the Regulations, which had previously been disclosed in the 2012 Annual Report as a total aggregated figure in the notes section.

Analysis of Non-Executive Directors' taxable benefits – audited

Non-Executive Directors: taxable benefits	Taxable benefits: accompanied attendance at business functions £'000		Taxable benefits: travel expenses and 'walk-in' medical services £'000		Total taxable benefits £'000	
	2013	2012	**2013**	2012	**2013**	2012
Karen de Segundo	**–**	–	**1**	–	**1**	–
Ann Godbehere	**–**	–	**1**	2	**1**	2
Christine Morin-Postel	**–**	–	**9**	3	**9**	3
Gerry Murphy	**–**	–	**1**	1	**1**	1
Kieran Poynter	**–**	–	**–**	–	**–**	–
Anthony Ruys	**1**	–	**13**	7	**14**	7
Richard Tubb (from 28 Jan 2013)	**7**	N/A	**47**	N/A	**54**	N/A
Retired Non-Executive Directors						
Robert Lerwill (to 25 Apr 2013)	**–**	–	**3**	5	**3**	5
Sir Nicholas Scheele (to 25 Apr 2013)	**12**	–	**69**	52	**81**	52
Total	**20**	–	**144**	70	**164**	70

Notes:
1. The figures shown for benefits are gross amounts, as appropriate, and it is the normal practice of the Company to pay the tax which may be due on any benefits.
2. The Non-Executive Directors' taxable benefits for 2012 have been restated where appropriate following the individual apportionment of travel expenses, as required under the Regulations, which had previously been disclosed in the 2012 Annual Report as a total aggregated figure in the notes section.

Fees

The basis for the fees is set out in the Policy Table above. The fees' structure applied during 2013 is set out in the table below.

Non-Executive Directors – fee structure	Jan-Dec 2013 £
Basic fee	**90,000**
Supplements:	
– Senior Independent Director	**30,000**
– Audit Committee Chairman	**30,000**
– CSR Committee Chairman	**25,000**
– Nominations Committee Chairman	**–**
– Remuneration Committee Chairman	**30,000**
Committee Memberships Fees (not Chairman):	
– Audit Committee	**6,250**
– CSR Committee	**6,250**
– Nominations Committee	**–**
– Remuneration Committee	**6,250**

Remuneration Report
Annual Report on Remuneration continued

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. 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.

Non-Executive Director – Anthony Ruys: ITC Limited – audited

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 2013, Anthony Ruys received INR 780,000 (£7,614) in fees from ITC (2012: INR 740,000 (£8,309)). 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 as set out below.

Anthony Ruys ITC Employee Stock Option Scheme – share options over ordinary shares of INR1 each in ITC Limited – audited	At 1 Jan 2013 Number of options[2]	Grant date	Grant price per option	Granted in 2013 Number of options	Exercised at 31 Dec 2013 Number of options	At 31 Dec 2013 Number of options[2]	Number of options that may be exercised	Dates from which exercisable	Latest expiry date
	20,000	23 Jul 2009	Rs. 1,090.00			**20,000**	6,000	23 Jul 2010	23 Jul 2015
							6,000	23 Jul 2011	23 Jul 2016
							8,000	23 Jul 2012	23 Jul 2017
	20,000	22 Jul 2010	Rs. 1,461.75			**20,000**	6,000	22 Jul 2011	22 Jul 2016
							6,000	22 Jul 2012	22 Jul 2017
							8,000	22 Jul 2013	22 Jul 2018
	10,000	26 Aug 2011	Rs. 2,023.50			**10,000**	3,000	26 Aug 2012	26 Aug 2017
							3,000	26 Aug 2013	26 Aug 2018
							4,000	26 Aug 2014	26 Aug 2019
	10,000	27 Jul 2012	Rs.2,494.50			**10,000**	3,000	27 Jul 2013	27 Jul 2018
							3,000	27 Jul 2014	27 Jul 2019
							4,000	27 Jul 2015	27 Jul 2020
		28 Aug 2013	Rs. 2,979.00	10,000		**10,000**	3,000	28 Aug 2014	28 Aug 2019
							3,000	28 Aug 2015	28 Aug 2020
							4,000	28 Aug 2016	28 Aug 2021
Total	60,000			10,000		**70,000**	70,000		

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 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 the date of grant; (b) 30% vests 24 months from the date of grant; and (c) 40% vests 36 months from the date of grant.

Single total figures for Directors' remuneration

Non-Executive Directors – Chairman: Aggregate – audited

The following table shows a single figure of remuneration for the Chairman in respect of qualifying services for the year ended 31 December 2013 together with comparative figures for 2012. The aggregate Directors' emoluments are shown below.

Chairman	**Fees £'000**		**Taxable benefits/Other emoluments £'000**		**Total remuneration £'000**	
	2013	2012	**2013**	2012	**2013**	2012
Richard Burrows	**615**	593	**105**	99	**720**	692

Analysis of taxable benefits/other emoluments		
Taxable benefits[1]		
– health insurance	**13**	12
– use of a company driver	**59**	61
– installation and maintenance of home security systems in the UK and Ireland	**13**	7
– hotel accommodation and related expenses incurred in connection with individual and/or accompanied attendance at certain business functions and/or corporate events	**14**	7
Other emoluments		
– commuting flights to London	**6**	12
Total taxable benefits/other emoluments	**105**	99

Note:
1. The figures shown for taxable benefits are gross amounts as it is the normal practice of the Company to pay the tax which may be due on any benefits.

The Remuneration Committee is responsible for determining the terms of engagement and fees payable to the Chairman. The current terms of Richard Burrows' appointment provide for: (1) an annual fee of £620,000; (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.

Aggregate Directors' Emoluments – audited

The aggregate emoluments of the Directors of the Company were as follows:

	Executive Directors		**Chairman**		**Non-Executive Directors**		**Total**	
	2013 £'000	2012 £'000	**2013 £'000**	2012 £'000	**2013 £'000**	2012 £'000	**2013 £'000**	2012 £'000
Salary	**2,609**	2,492	**–**	–	**–**	–	**2,609**	2,492
Fees	**–**	–	**615**	593	**850**	887	**1,465**	1,480
Taxable benefits	**830**	396	**99**	87	**164**	70	**1,093**	553
Short-term incentives	**4,042**	4,040	**–**	–	**–**	–	**4,042**	4,040
Long-term incentives	**4,825**	5,413	**–**	–	**–**	–	**4,825**	5,413
Pension	**1,394**	1,752	**–**	–	**–**	–	**1,394**	1,752
Other emoluments	**740**	971	**6**	12	**–**	–	**746**	983
Total emoluments	**14,440**	15,064	**720**	692	**1,014**	957	**16,174**	16,713

Remuneration Report
Annual Report on Remuneration continued

Total pension entitlements

Executive Directors' pension entitlements – audited

Pension values	Normal retirement age	Accrued pension at year end 31 Dec 2013 £'000	Additional value of pension on early retirement £'000
Nicandro Durante			
UURBS (UK)	60	64	–
Fundacao Albino Souza Cruz (FASC – Brazil)	60	367	–
Total		431	
Ben Stevens			
Pension Fund (UK)	60	95	–
UURBS (UK)	60	197	–
Total		292	
John Daly			
P J Carroll (Ireland)	60	92	–
Pension Fund (UK)	60	33	–
UURBS (UK)	60	133	–
Total		258	

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 the statute before retirement.
2. 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.
3. Nicandro Durante and John Daly: the pension entitlements for the FASC and P J Carroll Directors' Plan are denominated in Brazilian real and Euros respectively.

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

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

Nicandro Durante's pension entitlements are as follows:

(1) From December 1981 to March 2012, 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 have remained subject to the rules of that scheme.

Following legislative changes to the applicable UK tax relief regulations in respect of overseas pension arrangements, Nicandro Durante's FASC pension benefits have been in payment since 1 April 2012 and currently amount to approximately £367,000 per annum (after adjusting for currency exchange) reflecting Nicandro Durante's 31 years' service at Souza Cruz. The Remuneration Committee has ruled that the resulting tax charges (in variable amounts) for the prior years from 2006 to 2012 would be tax equalised in 2013 by way of a non-recurring gross payment of £440,000 in respect of this liability to Nicandro Durante. No further compensation payment was made or element of remuneration adjusted in lieu of there being no further pension accrual in the FASC.

(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; £747,494 per annum with effect from 1 April 2013. 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 Designate), 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.

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

Ben Stevens and John Daly each joined the British American Tobacco UK Pension Fund (the 'Pension Fund') after 1989 and before the closure of its non-contributory defined benefit section to new members in April 2005. As a result, prior to 6 April 2006, these individuals were subject to the HMRC cap on pensionable earnings (notionally £141,600 for the tax year 2013/14). 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 £6,640 being provided through the UURBS. Ben Stevens has reached his lifetime allowance of £1.8m 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.

John Daly – P J Carroll Directors' Plan

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 €110,776 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. John Daly stepped down as Chief Operating Officer on 31 December 2013 and he transferred the value of this deferred benefit out of the PJ Carroll Directors' Plan to a private arrangement in January 2014. He will cease to be an Executive Director on 6 April 2014.

Remuneration Report
Annual Report on Remuneration continued

Directors' shareholdings and scheme interests

Executive Directors' shareholding guidelines

The shareholding guidelines require Executive Directors to hold shares in the Company equal to the value of a percentage of salary as set out in the table below. The shares held to meet the requirements must exclude shares earned but not yet vested under the Company's short-term (DSBS) and long-term (LTIP) incentive plans as well as those held in trust under the all-employee share ownership plan (SIP). These guidelines are considered to be a practical way in which the Executive Directors are encouraged to build up a high level of personal shareholding to ensure a continuing alignment of interests with shareholders.

	Share ownership requirements (% of base salary) 31 Dec 2013	No. of eligible ordinary shares held at 31 Dec 2013	Value of eligible ordinary shares held at 31 Dec 2013 £m	Actual percentage (%) of base salary at 31 Dec 2013
Nicandro Durante	300 (400 from 1 Jan 14)	**159,040**	**5.1**	**468.2**
Ben Stevens	200 (250 from 1 Jan 14)	**58,360**	**1.9**	**231.3**
John Daly (retires 6 Apr 2014)	200	**44,792**	**1.5**	**201.2**

Notes:
The closing mid-market price of ordinary shares on 31 December 2013 was 3,238p.

Arrangements are in place for those Executive Directors who do not meet, at any one point, the requirements of the shareholding guidelines. In such cases, individuals may, generally, only sell a maximum of up to 50% of any shares vesting (after tax) under the Company share plans until the threshold required under the shareholding guidelines has been met. There are no formal shareholding requirements for the Non-Executive Directors although they are encouraged to build a small interest in shares during the term of their appointment.

With effect from 1 January 2014 and in respect of shareholders' requests made during the Company's policy consultations, the shareholding guidelines for Executive Directors have been increased as stated in the table above.

Share interests – audited

The interests of the Directors who served during the year ended 31 December 2013, in the ordinary shares of the Company (beneficial, family and any connected persons) are as follows:

	Shares held		SIP shares[6]		DSBS: deferred shares				
	Owned outright		Held in employee benefit trust		Unvested: subject to continued employment				
	At 1 Jan 2013	At 31 Dec 2013	At 1 Jan 2013	At 31 Dec 2013	At 1 Jan 2013	Awarded on 22 Mar 2013 Number of shares	Released on 25 March 2013 Number of shares[2]	At 31 Dec 2013	At 31 Dec 2013 Number of shares
Executive Directors									
Nicandro Durante	150,713	**159,040**	1,209	**1,374**	70,233	25,478	17,005	78,706	**239,120**
Ben Stevens	57,977	**58,360**	915	**1,018**	60,668	17,079	15,925	61,822	**121,200**
John Daly	48,306	**44,792**	289	**280**	44,669	15,069	8,601	51,137	**96,209**
Chairman									
Richard Burrows	10,000	**10,000**							**10,000**
Non-Executive Directors									
Karen de Segundo	2,000	**2,000**							**2,000**
Ann Godbehere[1]	477	**2,907**							**2,907**
Christine Morin-Postel	3,000	**3,000**							**3,000**
Gerry Murphy	3,000	**3,000**							**3,000**
Kieran Poynter	5,000	**5,000**							**5,000**
Anthony Ruys[5]	3,000	**3,000**							**3,000**
Richard Tubb (from 28 January 2013)	–	**–**							**–**
Former Directors									
Robert Lerwill (to 25 April 2013)	3,000	**3,000**							**N/A**
Sir Nicholas Scheele (to 25 April 2013)	5,000	**5,000**							**N/A**

Notes:
1. Ann Godbehere: these share interests include 1,215 American Depositary Receipts, each of which represents two ordinary shares in the Company.
2. The closing mid-market price on the date of release (25 March 2013) was 3,509p.
3. Based on the performance for 2013, the Executive Directors will each be awarded a number of ordinary shares to the value of £2,440 pursuant to an award of shares under the Share Reward Scheme on 1 April 2014.
4. On 31 December 2013, the Group's employee share ownership trust, referred to later in this Remuneration Report, held a total of 8,929,075 ordinary shares in the Company. All participating employees, including the Executive Directors, are deemed to have a beneficial interest in these shares.
5. Anthony Ruys as a non-executive director of ITC Limited (ITC) (an associate undertaking of the Company) has interests in share options granted to him by ITC under its stock options scheme. Details of these share interests are set out above.
6. The SIP shares comprise vested and unvested shares in the Share Incentive Plan (Partnership Share Scheme and Share Reward Scheme/International Share Reward Scheme).

Scheme interests – share incentive awards – audited

The scheme interests of the Executive Directors who served during the year ended 31 December 2013 in the shares of the Company under the Long-Term Incentive Plan (LTIP) are as follows:

	LTIP shares balance 1 Jan 2013	LTIP shares awarded in 2013	Award date	LTIP shares vested in 2013 (25 Mar 2013)	LTIP shares lapsed in 2013	LTIP shares exercised in 2013	LTIP shares balance 31 Dec 2013	Performance period
Nicandro Durante								
	69,751		25 Mar 2010	60,753	8,998	60,753		2010/2012
	147,329		13 May 2011				**147,329**	2011/2013
	124,688		28 Mar 2012				**124,688**	2012/2014
		119,828	22 Mar 2013				**119,828**	2013/2015
Total	341,768	119,828		60,753	8,998	60,753	**391,845**	
Ben Stevens								
	65,323		25 Mar 2010	56,896	8,427	56,896		2010/2012
	79,558		13 May 2011				**79,558**	2011/2013
	70,137		28 Mar 2012				**70,137**	2012/2014
		66,932	22 Mar 2013				**66,932**	2013/2015
Total	215,018	66,932		56,896	8,427	56,896	**216,627**	
John Daly								
	37,643		25 Mar 2010	32,787	4,856	32,787		2010/2012
	71,823		13 May 2011				**71,823**	2011/2013
	60,785		28 Mar 2012				**60,785**	2012/2014
		59,058	22 Mar 2013				**59,058**	2013/2015
Total	170,251	59,058		32,787	4,856	32,787	**191,666**	

Notes:

1. The Non-Executive Directors do not participate in the LTIP.
2. There have been no variations in the terms and conditions of the LTIP interests during the year.

Scheme interests – share options – audited

The scheme interests of the Executive Directors who served during the year ended 31 December 2013 in the shares of the Company under the Sharesave Scheme are as follows:

	At 1 Jan 2013 Number of shares	Grant date	Grant price pence	Granted in 2013	Exercised in 2013	At 31 Dec 2013 Number of shares	Date from which exercisable	Latest expiry date
Nicandro Durante	591	28 Mar 2012	2,536.0			**591**	May 2017	Oct 2017
Ben Stevens	1,000	25 Nov 2009	1,555.0			**1,000**	Jan 2015	Jun 2015
John Daly	457	25 Mar 2011	1,974.0			**457**	May 2014	Oct 2014

Notes:

1. The Non-Executive Directors do not participate in the Sharesave Scheme.
2. No options lapsed for the Executive Directors during the year ended 31 December 2013. There have been no variations in the terms and conditions of these interests in share options during the year.
3. The aggregate gain on the exercise of Sharesave options was £nil (2012: £26,402).

Remuneration Report
Annual Report on Remuneration continued

Scheme interests awarded during the year ended 31 December 2013 – audited

Executive Directors	Scheme	Date of award	Basis of award – multiple of base salary %	Face value £'000	Percentage vesting at threshold performance	No. of shares	Performance period end date	Awards exercisable
Nicandro Durante	LTIP	22 Mar 2013	400	4,200	20	119,828	31 Dec 2015	22 Mar 2016 – 21 Mar 2023
Ben Stevens	LTIP	22 Mar 2013	300	2,346	20	66,932	31 Dec 2015	22 Mar 2016 – 21 Mar 2023
John Daly	LTIP	22 Mar 2013	300	2,070	20	59,058	31 Dec 2015	22 Mar 2016 – 21 Mar 2023

Note:
1. The face value of awards is calculated by reference to the share price at the date of grant of the award: 3,505p.
2. The percentage vesting at threshold performance is broken down as follows:

TSR – FTSE 100 group of companies	
Ranking – median	
Percentage of vesting award	6
TSR – FMCG peer group	
Ranking – median	
Percentage of vesting award	6
Earnings per share growth	
Percentage per annum above inflation 3% Percentage of vesting award	8
Total	**20**

Shareholder dilution – options and awards outstanding

In accordance with the guidelines of the Association of British Insurers (ABI), the Company can satisfy awards under all its share plans (LTIP (and its predecessor, the 1998 LTIP), SIP and Sharesave Scheme) with new issue shares or shares issued from treasury up to a maximum of 10% of its issued share capital in a rolling ten-year period to employees under all its share plans. Within this 10% limit, the Company can only issue (as newly issued shares or from treasury) 5% of its issued share capital to satisfy awards under discretionary or executive plans. The Company's former executive share option plan (the 'Share Option Scheme') closed to further grants in March 2004; 95,266 options were outstanding as at 31 December 2013 and could be satisfied by the issue of new shares before expiry in March 2014. The rules of the Company's Deferred Share Bonus Scheme (DSBS) do not allow for the satisfaction of awards by the issue of new shares.

During the year, new ordinary shares were issued by the Company in relation to the Sharesave Scheme. Under the Sharesave Scheme, a total of 728,873 options over ordinary shares in the Company were outstanding at 31 December 2013, representing 0.04% of the Company's issued share capital (excluding shares held in treasury). The options outstanding under the Sharesave Scheme are exercisable until end October 2018 at option prices ranging from 1,435p to 2,807p.

The British American Tobacco Group Employee Trust (BATGET)

BATGET is used to satisfy the vesting and exercise of awards of ordinary shares made under the DSBS, the LTIP (and the 1998 LTIP) as well as the exercise of options under the closed 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 £700 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 £603 million at 31 December 2013 (2012: £538 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 2013	31 December 2013
Number of ordinary shares	10,520,098	8,929,075
Market value of ordinary shares	£328.3m	£289.1m
Percentage of the issued share capital of the Company %	0.51	0.44

BATGET currently waives dividends on the ordinary shares held by it. BATGET waived payment of the final dividend for 2012 of £9.4 million in May 2013 and the interim dividend for 2013 of £4.1 million in September 2013. The trustee does not exercise any voting rights while shares are held by BATGET. As soon as shares held in BATGET are transferred out to share scheme participants, the participants may exercise the voting rights attaching to those shares. Details of the Company's material share-based payment arrangements, reflecting both equity share-based and cash-settled share-based arrangements, are set out in note 27 on the accounts.

Other required disclosures

Payments to former directors

The Company made no payment of money or other assets to former Directors during the year ended 31 December 2013.

Payments for loss of office

The Company made no payments to Directors for loss of office during the year ended 31 December 2013.

Voting on the Remuneration Report at the 2013 AGM

At the AGM on 25 April 2013, the shareholders considered the annual advisory vote on the Directors' Remuneration report under the legal regime that preceded the Regulations. No other resolutions in respect of Directors' remuneration and incentives were considered at the AGM. The voting outcome is set out in the table below.

Resolution	Votes for including discretionary votes	Percentage for	Votes against	Percentage against	Total votes cast excluding votes withheld	Votes withheld[1]	Total votes cast including votes withheld
Approval of Directors' Remuneration Report	1,257,995,534	91.36	78,807,245	5.72	1,336,802,779	40,209,042	1,377,011,821

Note:
1. Votes withheld are not included in the final proxy figures as they are not recognised as a vote in law.

The Company undertook a regular programme of engagement with institutional shareholders and their representative bodies during the run-up to the AGM. A wide range of issues were discussed and feedback was generally positive. Details of the charges introduced following shareholder consultation on remuneration are set out in the Chairman's annual statement and in note 3 to the Future Policy Table.

No vote was required to be taken in relation to the Directors' remuneration policy at the 2013 AGM.

Remuneration Report
Annual Report on Remuneration continued

Directors' remuneration in the year ending 31 December 2014

Proposed implementation of remuneration policy in 2014

The remuneration policy for the Executive Directors and the Non-Executive Directors is set out in the policy report and was effective from 1 January 2014. Subject to shareholder approval at the AGM on 30 April 2014, it will become binding on the Company and it will become the approved shareholder policy (the '2014 Policy'). The Policy Report explains the work undertaken by the Remuneration Committee, in consultation with the Company's largest shareholders, to produce revised remuneration structure as set out in the Future Policy Table (see page 65).

The basic elements to note for 2014 are set out below.

Executive Directors – base salary

Executive Directors – salaries	Base salary from 1 Apr 2014 £	Percentage change %	Base salary from 1 Apr 2013 £
Nicandro Durante	**1,155,000**	5.00	1,100,000
Ben Stevens	**841,500**	3.00	817,000
John Daly (retires in April 2014)	**721,000**	–	721,000

Short-term incentives: International Executive Incentive Scheme (IEIS)

IEIS – Executive Directors 50% in cash, 50% in deferred shares[1]	2014 Maximum opportunity %	2013 Maximum opportunity %
Nicandro Durante	**200**	200
Ben Stevens	**180**	180
John Daly (retires in April 2014)	**–**[2]	180

IEIS: performance measures for 2014[3]	Weighting %
Adjusted profit from operations	**40**
Group's share of key markets	**20**
Global Drive Brand (GDBs) and Key Strategic Brands volumes	**20**
Cash flow from operations	**20**

Notes:

1. There is an individual performance element which can be awarded (being an adjustment factor of either 10% or 20% of the annual corporate result) and is paid in cash. In cases of identified poor personal performance, the corporate result will be reduced by 50%. The individual adjustment factor is capped so that under no circumstances can the maximum award levels of 200% and 180% be exceeded.
2. John Daly will retire as an Executive Director in April 2014 and will cease to be an employee of the Company from that date. In accordance with the rules of the IEIS, his performance-related bonus in respect of the year ending 31 December 2014 will be pro-rated for his period of service in 2014 at an 'on-target' outcome, payable on retirement as a 100% cash bonus instead of 50% in cash and 50% in deferred shares.
3. The specific target percentages for the performance measures at threshold, target and maximum levels for 2014 are considered to be commercially sensitive because of the information that this provides to market competitors. Further, the ranges of indicative performance only will be disclosed after the end of the financial year in the 2014 Annual Report on Remuneration published in 2015. The Remuneration Committee will review the commercial confidentiality of the targets and outcomes on an ongoing basis.

Long-term incentives: Long-Term Incentive Plan (LTIP)

LTIP – Executive Directors Award levels – maximum opportunity	2014 Multiple of base salary %	2013 Multiple of base salary %
Nicandro Durante	**400**	400
Ben Stevens	**300**	300
John Daly (retires in April 2014)	**–**	300

LTIP: measurement of performance 2014	Weighting %
TSR – FMCG comparator group	**25**
EPS – growth in range of 5% to 10%	**50**
NTO – net turnover with underlying operating profit underpin	**25**

Non-Executive Directors' fees

	Fees from 1 Jan 2014 £	Jan-Dec 2013 £
Basic fee	**90,000**	90,000
Supplements:		
– Senior Independent Director	**30,000**	30,000
– Audit Committee Chairman	**30,000**	30,000
– CSR Committee Chairman	**25,000**	25,000
– Nominations Committee Chairman	**–**	–
– Remuneration Committee Chairman	**30,000**	30,000
Committee Memberships Fees (not Chairman):		
– Audit Committee	**6,000**	6,250
– CSR Committee	**6,000**	6,250
– Nominations Committee	**6,000**	–
– Remuneration Committee	**6,000**	6,250

Chairman's fees

	Fees from 1 April 2014 £	Fees at 1 April 2013 £
Richard Burrows	**632,400**	620,000

On behalf of the Board

Gerry Murphy
Chairman of the Remuneration Committee
26 February 2014

Other disclosures

Strategic report disclosures

Section 414C(11) of the Companies Act 2006 allows the Board to include in the Strategic Report information that it considers to be of strategic importance that would otherwise need to be disclosed in the Directors' Report. The Board has chosen to take advantage of this provision and accordingly, the information set out below, which would otherwise be required to be contained in the Directors' Report, has been included in the Strategic Report.

Information required in the Directors' Report	Section in the Strategic Report
Certain risk information about the use of financial instruments	Financial review
An indication of likely future developments in the business of the Group	Delivering our strategy
An indication of the activities of the Group in the field of research and development	Delivering our strategy: Sustainability
A statement describing the Group's policy regarding the hiring, continuing employment and training, career development and promotion of disabled persons	Delivering our strategy: Winning organisation
Details of employee engagement: information, consultation, share scheme participation and the achievement of a common awareness of the financial and economic factors affecting the performance of the Group	Delivering our strategy: Winning organisation
Disclosures concerning greenhouse gas emissions	Delivering our strategy: Sustainability

Dividends

Final dividend – recommendation

The Board recommends to shareholders for approval at the Annual General Meeting on 30 April 2014, a final dividend of 97.4p per ordinary share of 25p for the year ended 31 December 2013.

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 2014
Last day to trade (LDT) cum-dividend (JSE)	7 March
Shares commence trading ex-dividend (JSE)	10 March
Shares commence trading ex-dividend (LSE)	12 March
Record date (JSE and LSE)	14 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 = 17.89670 as at 25 February 2014 (the closing rate for that date as quoted on Bloomberg), results in an equivalent final dividend of 1,743.13858 SA cents per ordinary share. From the commencement of trading on 27 February 2014 (the date of the preliminary announcement) until the close of business on 14 March 2014, 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 7 March 2014 until the close of business on 14 March 2014, no transfers between the UK main register and the South Africa branch register are permitted and no shares may be dematerialised or rematerialised between 10 and 14 March 2014, both days inclusive.

South Africa branch register: Dividends Tax information

South Africa Dividends Tax of 261.47079 SA cents per ordinary share will be withheld from the gross final dividend paid to shareholders on the South Africa branch register at the rate of 15% unless a shareholder qualifies for an exemption. After Dividends Tax has been withheld, the net dividend will be 1,481.66779 SA cents per ordinary share.

The Company, as a South Africa non-resident, was not subject to the secondary tax on companies (STC) regime which used to operate before the introduction of Dividends Tax. No STC credits are available for set-off against the Dividends Tax liability on the final dividend which is regarded as a 'foreign dividend' for the purposes of the South Africa Dividends Tax. British American Tobacco p.l.c. is registered with the South African Revenue Service (SARS) with tax reference number 9378193172.

Dividends Tax and the information provided above is only of direct application to shareholders on the South Africa branch register. Shareholders on the South Africa branch register should refer to 'Shareholder and contact information' for the contact details of Computershare Investor Services (Pty) Ltd, the Company's registrar for the branch register.

Dividend information

Further details of the total amounts of dividends paid in 2013 (with 2012 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 30 April 2014. Details of the business to be proposed at the meeting are contained in the Notice of AGM which is sent to all shareholders and published on www.bat.com.

The Company provides for the vote on each resolution to be by poll rather than by show of hands. This provides for greater transparency and allows the votes of all shareholders to be counted, including those cast by proxy. The voting results are announced on the same day through the Regulatory News Service and on www.bat.com.

Share capital

As at 31 December 2013, the Company had an allotted and fully paid share capital of 2,026,456,406 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 25 February 2014 (the latest practicable date prior to the recommendation of the final dividend for the year ended 31 December 2013), the Company had a total of 1,887,026,281 ordinary shares in issue (excluding treasury shares). The Company held 139,516,345 ordinary shares in treasury giving a total issued share capital of 2,026,542,626 ordinary shares.

Other disclosures
continued

Significant shareholders

At 31 December 2013, 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 26 February 2014, the Company had not received notification either of any change in the interests below or that any other person holds 3% or more of its ordinary shares.

Name	Number of ordinary shares	% of issued share capital
BlackRock, Inc.	132,891,526	7.04
Reinet Investments S.C.A.	76,518,264	4.06
The Capital Group Companies, Inc.	67,664,399	3.59

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

Stock market listings

Premium listing

The ordinary shares of the Company (as British American Tobacco p.l.c.) have been listed on the Official List and traded on the main market of the London Stock Exchange for listed securities since 8 September 1998 (Share Code: BATS and ISIN: GB0002875804). This is classified as a premium listing. The share registrar is Computershare Investor Services plc.

Secondary listing

The Company's ordinary shares have a secondary listing on the JSE Limited in South Africa (JSE), under the abbreviated name BATS and the trading code BTI. As at 31 December 2013, 313,075,671 ordinary shares of the Company (being 16.59% 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 2013, 39,536,451 ADRs were outstanding, represented by 79,072,902 ordinary shares. Citibank, N.A. continues to act as depositary for the ADR programme following a review of the ADR supplier and a renewal of their agreement, negotiated in 2013.

The Company has unlisted trading privileges for the ADR programme and none of its securities are listed on any United States securities exchange or registered pursuant to the securities laws of the United States. As a result, the Company is subject to neither the NYSE MKT listing standards nor the corporate governance rules under the Sarbanes-Oxley Act of 2002. Nevertheless, the Board has chosen, in the interests of good governance, to make a voluntary statement explaining the principal differences and common areas between the Company's corporate governance practices and those that would be required if the Company were subject to those rules. The statement is available at www.bat.com/governance.

Purchase of own shares

Share buy-back programme 2013

The Board reinstated its on-market share buy-back programme on 1 March 2013 following the Company's Preliminary Announcement on 28 February 2013 and under the authority granted by shareholders in 2012. At the 2013 AGM, the Company was given authority to purchase up to 192,800,000 of its ordinary shares. The minimum price that may be paid for such shares is 25p and the maximum price is an amount equal to 105% 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 2013, the Company made on-market repurchases totalling 43,623,858 of its own ordinary shares, representing 2.31% of the issued share capital (excluding treasury shares) as at 31 December 2013 and at a value of £1,500 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 2013 the number of treasury shares was 139,516,345. 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 2014 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. Further details are contained in the Notice of Annual General Meeting which is sent to all shareholders and is also published on www.bat.com.

Significant agreements – change of control

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

On 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.

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.

Directors' interests and indemnities

Further details of Directors' contracts and letters of appointment, remuneration and emoluments, and their interests in the Company's shares (including share options and deferred shares) as at 31 December 2013 are given in the Remuneration Report. No Director had any material interest in a contract of significance (other than a service contract) with the Company or any subsidiary company during the year.

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

Information and advice

The Board and its Committees receive papers for review in good time ahead of each meeting. The Company Secretary ensures good information flow within the Board and its Committees, and between the Non-Executive Directors and senior management. She also advises the Board on all governance matters.

All Directors have access to the advice and services of the Company Secretary, and a procedure is in place for them to take independent professional advice at the Company's expense if required. Each of the four principal Committees of the Board may obtain independent legal or other professional advice, at the Company's expense, and secure attendance at meetings of outsiders if needed.

Articles of Association

The following description summarises certain provisions of the Company's current Articles of Association (as adopted by special resolution at the AGM on 28 April 2010), applicable English law and the Companies Act 2006 (the 'Companies Act'). This summary is qualified in its entirety by reference to the Companies Act and the Company's Articles of Association, available on www.bat.com.

Share capital

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

Objects and purposes

The Company is incorporated under the name of British American Tobacco p.l.c. and is registered in England and Wales under registered number 3407696. Under the Companies Act 2006, the Company's objects are unrestricted.

Directors: appointment and retirement

The Company's Articles of Association provide for a Board of Directors, consisting (unless otherwise determined by ordinary resolution of the shareholders) of not fewer than five Directors, and not subject to any maximum.

The Directors and the Company (by ordinary resolution) may appoint a person who is willing to act as a Director, either to fill a vacancy or as an additional Director. A Director appointed by the Directors shall retire at the next AGM and will put himself/herself forward to be reappointed by the shareholders. Such a Director shall not be taken into account in determining the number or identity of the Directors to retire by rotation at that next AGM.

At each AGM, all Directors shall retire from office by rotation who: (1) held office at the time of each of the two preceding AGMs and who did not retire at either of them; and (2) if the number of Directors retiring in (1) above is less than one-third of the Directors who are subject to retirement by rotation (or, if their number is not three or a multiple of three, is less than the number which is nearest to but does not exceed one-third of the Directors), such additional number of Directors as shall, together with the Directors retiring under (1) above, equal one-third of the Directors (or, if their number is not three or a multiple of three, the number which is nearest to but does not exceed one-third of the Directors).

Subject to the provisions of the Companies Act and the Articles of Association, the Directors to retire at an AGM under (2) above will be those who have been in office the longest since their appointment or last reappointment.

Notwithstanding these provisions contained in the Articles of Association, the Company is not restricted to the number of Directors who may retire and seek re-election each year. The Articles of Association merely set a minimum number of Directors who must be subject to retirement by rotation each year. As a result, since the introduction of the provision in the UK Corporate Governance Code in 2011 that all Directors of FTSE 350 companies should be subject to annual re-election by shareholders, all of the Directors of the Company will be subject to either election (i.e. those Directors appointed by the Board of Directors during the year) or re-election at the forthcoming AGM to be held on 30 April 2014.

A Director who retires at an AGM and is not reappointed shall retain office until the meeting elects someone in his place or, if it does not do so, until the conclusion of the meeting. In addition to any power of removal under the Companies Act, the Company may, by special resolution, remove a Director before the expiration of his period of office and, subject to the Articles of Association, may by ordinary resolution, appoint another person who is willing to act as a Director, and is permitted by law to do so, to be a Director instead of him. A person so appointed shall be subject to retirement as if he had become a Director on the day on which the Director in whose place he is appointed was last appointed or reappointed a Director.

Other disclosures
continued

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;

4. any proposal concerning the purchase of Directors' and officers' liability insurance;

5. any proposal concerning his being, or intending to become, a participant in the underwriting or sub-underwriting of an offer of any such shares, debentures or other securities for subscription, purchase or exchange;

6. any arrangements which relate in any way to a retirement benefits scheme or any arrangement for the benefit of the employees of the Company or any of its subsidiaries including but without being limited to an employees' share scheme, which does not accord to any Director any privilege or advantage not generally accorded to the employees and/or former employees to whom the arrangement relates; and

7. any transaction or arrangement with any other company, being a company in which the Director is interested only as an officer, creditor or shareholder, provided that he is not the holder of or beneficially interested in 1% or more of the equity share capital of that company (or of any other company through which his interest is derived) and not entitled to exercise 1% or more of the voting rights available to members of the relevant company (disregarding, for the purposes of this proviso: (i) any shares held by a Director as bare or custodian trustee and in which he has no beneficial interest; (ii) any shares comprised in an authorised unit trust scheme in which the Director is interested only as a unit holder; and (iii) any shares of that class held as treasury shares).

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

Directors: borrowing powers

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

Directors: interests

Provided that the Director has disclosed to the other Directors the nature and extent of any material interest of his, a Director, notwithstanding his office:

1. may be a party to, or otherwise interested in, any transaction or arrangement with the Company or in which the Company is otherwise interested;

2. may be a Director or other officer of, or employed by or may be a party to, or otherwise interested in, any transaction or arrangement with anybody corporate promoted by the Company or in which the Company is otherwise interested;

3. shall not, by reason of his office, be accountable to the Company for any benefit which he derives from any such office or employment or from any such transaction or arrangement or from any interest in any such body corporate;

4. shall not infringe his duty to avoid a situation in which he has, or can have, a direct or indirect interest that conflicts, or may possibly conflict, with the interests of the Company as a result of any such office or employment or from any such transaction or arrangement or from any interest in any such body corporate;

5. shall not be required to disclose to the Company, or use in performing his duties as a Director of the Company, any confidential information relating to such office or employment if to make such a disclosure or use would result in a breach of duty or obligation of confidence owed by him in relation to or in connection with that office or employment;

6. may absent himself from discussions and exclude himself from information, which will or may relate to that office, employment, transaction, arrangement or interest; and

7. no such transaction or arrangement will be liable to be avoided because of any such interest or benefit.

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

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

1. the Director shall not be required to disclose any confidential information relating to such matter, or such office, employment or position, to the Company if to make such a disclosure would result in a breach of a duty or obligation of confidence owed by him in relation to or in connection with that matter, or that office, employment or position;

2. the Director may absent himself from discussions, whether in meetings of the Directors or otherwise, and exclude himself from information which will or may relate to that matter, or that office, employment or position; and

3. a Director shall not, by reason of his office as a Director of the Company, be accountable to the Company for any benefit which he derives from such matter, office, employment or position.

Dividend rights

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

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

Any dividend which has been unclaimed for 12 years from the date it became due for payment shall, if the Directors so resolve, be forfeited and cease to be owed by the Company. The Company can cease sending dividend warrants and cheques by post or otherwise if these have been returned undelivered to, or left uncashed by, the shareholder on at least two consecutive occasions, or, if following one such occasion, reasonable enquiries have failed to establish the member's new address. No dividend shall bear interest against the Company, unless provided by the rights attached to the share.

The Directors may elect to pay dividends to shareholders by bank or electronic transfer only. Amounts due to shareholders who provide no, or invalid, account details may be held in an account in the Company's name until such shareholders nominate a valid account. The Company shall not be a trustee of any such monies, shall be deemed to have discharged its payment obligations by paying the relevant monies into such account and interest will not accrue for shareholders on any such monies pending payment to such persons.

Voting rights

Voting at any general meeting of shareholders is by a show of hands unless a poll is demanded. On a show of hands, every shareholder who is present in person at a general meeting has one vote regardless of the number of shares held by the shareholder.

Every proxy appointed by a shareholder and present at a general meeting has one vote, except that if the proxy has been duly appointed by more than one shareholder entitled to vote on the resolution and is instructed by one or more of those shareholders to vote for the resolution and by one or more others to vote against it, or is instructed by one or more of those shareholders to vote in one way and is given discretion as to how to vote by one or more others (and wishes to use that discretion to vote in the other way) he has one vote for and one vote against the resolution.

Other disclosures
continued

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

1. the Chairman of the meeting;
2. the Directors;
3. not less than five shareholders having the right to vote at the meeting;
4. a shareholder or shareholders representing not less than one-tenth of the total voting rights of all shareholders having the right to vote at the meeting (excluding any voting rights attached to treasury shares); or
5. a shareholder or shareholders holding shares which confer a right to vote on the resolution at the meeting being shares on which an aggregate sum has been paid up equal to not less than one-tenth of the total sum paid up on all shares conferring that right (excluding any voting rights attached to treasury shares).

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

1. ordinary resolutions, which can include resolutions for the appointment, reappointment and removal of Directors, the receiving of the Annual Report, the declaration of final dividends, the appointment and reappointment of the external auditor, the authority for the Company to purchase its own shares and the grant of authority to allot shares; and
2. special resolutions, which can include resolutions amending the Company's Articles of Association and resolutions relating to certain matters concerning a winding-up of the Company.

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

When convening a meeting the Company may specify a time not more than 48 hours before the time of the meeting (excluding any part of a day that is not a working day) by which a person must be entered on the register of members in order to have the right to attend or vote at the meeting.

Winding-up

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

Transfer of shares

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

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

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

If the Directors refuse to register a share transfer, they must give the transferee notice of this refusal as soon as practicable and in any event within two months of the instrument of transfer being lodged with the Company. No fees may be charged for registering a transfer.

Pre-emptive rights and new issues of shares

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

Alteration of share capital

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

1. consolidate and divide all or any of its shares into shares of a larger amount than its existing shares;
2. sub-divide any of its shares into shares of smaller amount than its existing shares; and
3. determine that, as between the shares resulting from such a sub-division, any of them may have any preference or advantage as compared with the others.

Subject to the provisions of the Companies Act:

1. the Company may reduce its share capital, its capital redemption reserve and any share premium account in any way; and
2. the Company may purchase its own shares, including redeemable shares, and may hold such shares as treasury shares or cancel them.

Disclosure of interests in the Company's shares

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

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

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

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

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

General meetings and notices

An AGM and all other general meetings of the Company must be called by at least 21 clear days' written notice. However, the Companies Act allows for this period of notice for meetings other than AGMs to be reduced to 14 clear days' notice provided that two conditions are met: (1) a company must allow shareholders to make proxy appointments via a website (such as that hosted by its share registrars); and (2) shareholders must pass a special resolution at the AGM every year approving that shortening of the notice period to 14 days. A special resolution enabling the Company to hold general meetings (other than AGMs) on 14 days' notice will be proposed at the AGM to be held on 30 April 2014.

Subject to the resolution being passed, the approval of the shortening of the notice period will be effective until the Company's next AGM, when it is intended that the approval be renewed. The shorter notice period would not be used as a matter of routine. Rather the Directors will consider on a case-by-case basis whether the use of the flexibility offered by the shorter notice period is merited, taking into account the circumstances, including whether the business of the meeting is time sensitive, and is thought to be to the advantage of shareholders as a whole. Further, the shorter notice period would not be used unless both of the conditions as stated above are met.

Variation of rights

If the capital of the Company is divided into different classes of shares, the rights attached to any class of shares may only be varied, either in such a manner as provided by those rights or in the absence of any provision, with the consent in writing of three-quarters in nominal value of the issued shares of that class or with the sanction of a special resolution passed at a separate meeting of holders of such shares. At any separate meeting, the necessary quorum is two persons together holding or representing by proxy at least one-third in nominal amount of the issued shares of the class (but at an adjourned meeting shall be any one person holding shares of the class or his proxy). Unless otherwise expressly provided by the rights attached to any shares, those rights shall be deemed to be varied by the reduction of the capital paid up on those shares and by the creation or issue of further shares ranking in priority for payment of a dividend or in respect of capital or which confer on the holders voting rights more favourable than those conferred by the first-mentioned shares, but shall not otherwise be deemed to be varied by the creation or issue of further shares ranking pari passu with them or subsequent to them.

Repurchase of shares

Subject to authorisation by shareholder resolution, the Company may purchase its own shares in accordance with the Companies Act. Any shares which have been bought back may be held as treasury shares or, if not so held, must be cancelled immediately upon completion of the purchase, thereby reducing the amount of the Company's issued share capital. There is no longer a requirement for public companies to have specific authorisations in their articles of association to undertake these actions.

The Strategic Report and the Directors' Report comprised in this Annual Report have been approved and are signed by order of the Board by:

Nicola Snook
Secretary
26 February 2014

British American Tobacco p.l.c.
Registered in England and Wales No. 3407696

Responsibility of Directors

Statement of the directors in relation to the annual report and financial statements

The Board confirms that it considers that this Annual Report, taken as a whole, is fair, balanced and understandable and provides information necessary for shareholders to assess the Company's performance, business model and strategy.

When making this assessment, the Board was supported by a recommendation from the Audit Committee, who oversaw well established and effective processes in relation to its preparation.

Directors' responsibilities in relation to the financial statements

The following statement sets out the responsibilities of the Directors in relation to the financial statements of both the Group and the Company. The reports of the independent auditors for the Group and the Company set out their responsibilities in relation to those financial statements.

Company law requires the Directors to prepare financial statements for each financial year that give a true and fair view of the state of affairs of the Company and the Group as at the end of the financial year and of the profit or loss of the Group and the Company for the financial year. In preparing those financial statements, the Directors are required to:

- select appropriate accounting policies and apply them consistently;
- make 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 and the Strategic Report include a fair review of the development and performance of the business and the position of the Group and the Company, together with a description of the principal risks and uncertainties that they face.

The names of the Directors are listed in this Directors' Report and their details appear on the Board of Directors page.

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

The responsibility statement was approved by the Board of Directors on 26 February 2014 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.

Report on the Group financial statements

Our opinion

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 2013 and of the Group's profit and cash flows for the year then ended;
- have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006 and Article 4 of the IAS Regulation.

This opinion is to be read in the context of what we say in the remainder of this report.

What we have audited

The Group financial statements, which are prepared by British American Tobacco p.l.c. ("BAT"), comprise:

- the Group Balance Sheet as at 31 December 2013;
- the Group Income Statement and the Group Statement of Comprehensive Income for the year then ended;
- the Group Statement of Changes in Equity and the Group Cash Flow Statement for the year then ended; and
- the Notes on the accounts, which include a summary of significant accounting policies and other explanatory information, the Principal subsidiary undertakings and Principal associate undertakings.

The financial reporting framework that has been applied in their preparation comprises applicable law and IFRSs as adopted by the European Union.

What an audit of financial statements involves

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) (ISAs (UK & Ireland)). An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of:

- whether the accounting policies are appropriate to the 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 Group financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Overview of our audit approach

Materiality

We set certain thresholds for materiality. These helped us to determine the nature, timing and extent of our audit procedures and to evaluate the effect of misstatements, both individually and on the financial statements as a whole.

Based on our professional judgement, we determined materiality for the Group financial statements as a whole to be £290 million, which represents approximately 5% of profit before taxation.

We agreed with the Audit Committee that we would report to them misstatements identified during our audit above £15 million as well as misstatements below that amount that, in our view, warranted reporting for qualitative reasons.

Overview of the scope of our audit

The Group is primarily structured across four geographic regions, being Asia-Pacific, Americas, Western Europe, and Eastern Europe, Middle East and Africa. The Group financial statements are a consolidation of 438 reporting units, comprising the Group's operating businesses and sales offices (often legal entities), centralised functions, and supply chain entities.

In establishing the overall approach to the Group audit, we determined the type of work that needed to be performed at the reporting units by us, as the group engagement team, or component auditors from other PwC network firms and other firms operating under our instruction. Where the work was performed by component auditors, we determined the level of involvement we needed to have in the audit work at those reporting units to be able to conclude whether sufficient appropriate audit evidence had been obtained as a basis for our opinion on the Group financial statements as a whole.

Independent auditors' report
continued

Accordingly, of the Group's 438 reporting units, we identified 52 which, in our view, required an audit of their complete financial information, either due to their size or their risk characteristics, providing 83% coverage over Group profit before taxation, spread across all geographic regions. Audits of these reporting units were performed using materiality levels lower than the materiality level for the Group as a whole, ranging from £10 million to £60 million, and established by reference to the size of, and risks associated with, the business concerned.

Specific audit procedures on certain balances and transactions were performed at a further 65 reporting units, one of which represents the results of an associate. The nature of the balances and transactions where specific audit procedures were performed differ to those at the Group's core operating businesses. This, together with additional procedures performed at the Group level relating primarily to taxation, litigation, pensions, and earnings per share, gave us the evidence we needed for our opinion on the Group financial statements as a whole.

Areas of particular audit focus

In preparing the financial statements, the Directors made a number of subjective judgements, for example in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain. We primarily focused our work in these areas by assessing the Directors' judgements against available evidence, forming our own judgements, and evaluating the disclosures in the financial statements.

In our audit, we tested and examined information, using sampling and other auditing techniques, to the extent we considered necessary to provide a reasonable basis for us to draw conclusions. We obtained audit evidence through testing the effectiveness of controls, substantive procedures or a combination of both.

We considered the following areas to be those that required particular focus in the current year. This is not a complete list of all risks or areas of particular audit focus identified by our audit. We discussed these areas of focus with the Audit Committee. Their report on those matters that they considered to be significant issues in relation to the financial statements is set out on page 54.

Area of focus	How the scope of our audit addressed the area of focus
Corporate Tax Exposures	
The Directors are required to apply significant judgement when determining whether, and how much, to provide in respect of material tax assessments leading to uncertain tax positions in a number of jurisdictions. (Refer to notes 6 and 30 in the notes on the accounts.) We focused on this area due to the significant quantum of gross risk and exposure across the Group, and the inherent complexity and judgement in estimating the amount of provision required.	We held a programme of meetings with the Group's Corporate Tax team and local management to understand the tax strategy and related tax risks, any associated technical tax issues, and the status of any current tax litigation. We assessed the appropriateness of provisions recorded in the financial statements, or the rationale for not recording a provision, having read the latest correspondence between the Group and the various tax authorities, and having obtained written responses from the Group's external legal advisors containing their views on material tax exposures and any related litigation.
Litigation	
The Group is subject to claims and class actions which could have a significant impact on the results if the potential exposures were to materialise. The Directors apply significant judgement when determining whether, and how much, to provide for matters of litigation. (Refer to notes 22 and 30 in the notes on the accounts.) We focused on this area due to the number and magnitude of potential exposures across the Group, and the inherent complexity and judgement in whether to provide for or disclose certain exposures.	We understood, assessed and tested management's controls in respect of litigation at the Group, regional and local level. We discussed the nature and status of exposures with in-house and external legal counsel. We obtained letters from the Group's lawyers to corroborate management's position for all significant litigation matters. We also read publicly available information containing recent updates in respect of court hearings and judgments impacting the Group. We assessed the appropriateness of provisions recorded in the financial statements, or the rationale for not recording a provision, and the completeness of disclosures in respect of contingent liabilities.
Restructuring and Integration costs	
During the year the Group has continued with the implementation of its revised Operating Model and single IT operating system in a number of markets. The accounting judgements and disclosure of costs associated with the project are complex, and give rise to an increased risk of error relating to inappropriate costs being capitalised.	We challenged the appropriateness of the Directors' policies in respect of project costs, including the nature of costs to be capitalised versus those that are immediately expensed, and the timing of determining when capitalised assets should be depreciated. We understood and evaluated management's controls over project costs, and any controls implemented as a result of the change programme. We tested costs incurred during the period to assess the appropriateness of £116 million costs capitalised versus £160 million that were expensed.

Area of focus	How the scope of our audit addressed the area of focus
Fraud in Revenue recognition	
ISAs (UK & Ireland) presume there is a risk of fraud in revenue recognition when management are under pressure to achieve planned results. Whilst revenue recognition and measurement is not complex for BAT, volume targets form part of the Group's key performance measures which could create an incentive to record revenue in the incorrect period. We focused on this area given the magnitude of revenue transactions that occur, and the opportunity that exists across markets to influence the timing of revenue recognition. (Refer to note 1 in the notes on the accounts.).	We understood and evaluated management's controls over revenue transactions, and over the monitoring of results at an end market, regional and Group level that are designed to detect unusual transactions. We challenged the appropriateness of the Directors' revenue recognition policies and tested the timing of revenue recognition, taking into account contractual obligations and any local market conditions that might lead to an increase or reduction in revenue outside of the normal pattern. We also tested journal entries posted to revenue accounts to identify unusual or irregular items, and we tested credit notes and returns after the balance sheet date for indicators that revenue may have been inappropriately recognised before the year end.
Risk of management override of internal controls	
ISAs (UK & Ireland) require that we consider this.	We assessed the overall control environment of the Group, including the arrangements for staff to "whistle-blow" inappropriate actions, and interviewed senior management and the Group's Internal Audit function. We considered whether there was evidence of bias by the Directors in the significant accounting estimates and judgements relevant to the financial statements. We performed unpredictable audit procedures at in scope audit units and tested journal entries.

Going Concern

Under the Listing Rules we are required to review the Directors' statement, set out on page 43, in relation to going concern. We have nothing to report having performed our review.

As noted in the Directors' statement, the Directors have concluded that it is appropriate to prepare the Group's financial statements using the going concern basis of accounting. The going concern basis presumes that the Group has adequate resources to remain in operation, and that the Directors intend it to do so, for at least one year from the date the financial statements were signed. As part of our audit we have concluded that the Directors' use of the going concern basis is appropriate.

However, because not all future events or conditions can be predicted, these statements are not a guarantee as to the Group's ability to continue as a going concern.

Opinion on matter prescribed by the Companies Act 2006

In our opinion the information given in the Strategic Report and the Directors' Report for the financial year for which the Group financial statements are prepared is consistent with the Group financial statements.

Other matters on which we are required to report by exception

Adequacy of information and explanations received

Under the Companies Act 2006 we are required to report to you if, in our opinion we have not received all the information and explanations we require for our audit. We have no exceptions to report arising from this responsibility.

Directors' remuneration

Under the Companies Act 2006 we are required to report to you if, in our opinion, certain disclosures of directors' remuneration specified by law have not been made. We have no exceptions to report arising from this responsibility.

Corporate Governance Statement

Under the Listing Rules we are required to review the part of the Corporate Governance Statement relating to the Company's compliance with nine provisions of the UK Corporate Governance Code ('the Code'). We have nothing to report having performed our review.

On page 112 of the Annual Report, as required by the Code Provision C.1.1, the Directors state that they consider the Annual Report taken as a whole to be fair, balanced and understandable and provides the information necessary for members to assess the Group's performance, business model and strategy. On page 54, as required by C.3.8 of the Code, the Audit Committee has set out the significant issues that it considered in relation to the financial statements, and how they were addressed. Under ISAs (UK & Ireland) we are required to report to you if, in our opinion:

- the statement given by the Directors is materially inconsistent with our knowledge of the Group acquired in the course of performing our audit; or
- the section of the Annual Report describing the work of the Audit Committee does not appropriately address matters communicated by us to the Audit Committee.

We have no exceptions to report arising from this responsibility.

Independent auditors' report
continued

Other information in the Annual Report

Under ISAs (UK & Ireland), we are required to report to you if, in our opinion, information in the Annual Report is:

- materially inconsistent with the information in the audited Group financial statements; or
- apparently materially incorrect based on, or materially inconsistent with, our knowledge of the Group acquired in the course of performing our audit; or
- is otherwise misleading.

We have no exceptions to report arising from this responsibility.

Responsibilities for the financial statements and the audit

Our responsibilities and those of the Directors

As explained more fully in the Directors' Responsibilities Statement set out on page 112, 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 ISAs (UK & Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report, including the opinions, has been prepared for and only for the Company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Other matter

We have reported separately on the Parent Company Financial Statements of British American Tobacco p.l.c. for the year ended December 31, 2013, and on the information in the Directors' Remuneration Report that is described as having been audited.

Paul Cragg (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London, United Kingdom

26 February 2014

Group Income Statement
For the year ended 31 December

	Notes	**2013 £m**	2012 Restated £m
Gross turnover (including duty, excise and other taxes of £30,925 million (2012: £30,682 million))		**46,185**	45,872
Revenue	2	**15,260**	15,190
Raw materials and consumables used		**(3,348)**	(3,445)
Changes in inventories of finished goods and work in progress		**105**	133
Employee benefit costs	3(a)	**(2,384)**	(2,426)
Depreciation, amortisation and impairment costs	3(b)	**(477)**	(475)
Other operating income	3(c)	**302**	245
Other operating expenses	3(d)	**(3,932)**	(3,850)
Profit from operations	2	**5,526**	5,372
Analysed as:			
– adjusted profit from operations	2	**5,820**	5,641
– restructuring and integration costs	3(e)	**(246)**	(206)
– amortisation of trademarks and similar intangibles	3(f)	**(74)**	(63)
– gain on deemed partial disposal of a trademark	3(g)	**26**	–
		5,526	5,372
Net finance costs	4	**(466)**	(456)
Finance income		**66**	49
Finance costs		**(532)**	(505)
Share of post-tax results of associates and joint ventures	5	**739**	676
Analysed as:			
– adjusted share of post-tax results of associates and joint ventures	2	**723**	681
– issue of shares and change in shareholding	5	**22**	20
– restructuring and integration costs	5	**(4)**	(24)
– other	5	**(2)**	(1)
		739	676
Profit before taxation		**5,799**	5,592
Taxation on ordinary activities	6	**(1,600)**	(1,516)
Profit for the year		**4,199**	4,076
Attributable to:			
Owners of the parent		**3,904**	3,797
Non-controlling interests		**295**	279
		4,199	4,076
Earnings per share			
Basic	7	**205.4p**	195.8p
Diluted	7	**204.6p**	194.8p

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

Prior year results have been restated with the adoption of the revised IAS 19 *Employee Benefits* as explained in note 12.

The accompanying notes are an integral part of the Group financial statements.

Group Statement of Comprehensive Income
For the year ended 31 December

	Notes	2013 £m	2012 Restated £m
Profit for the year (page 117)		**4,199**	4,076
Other comprehensive income			
Items that may be reclassified subsequently to profit or loss:		**(1,025)**	(337)
Differences on exchange			
– subsidiaries		**(972)**	(379)
– associates		**(141)**	(145)
Cash flow hedges			
– net fair value gains/(losses)		**94**	(11)
– reclassified and reported in profit for the year		**(49)**	71
– reclassified and reported in net assets		**(1)**	12
Available-for-sale investments			
– net fair value losses		**(7)**	(3)
– reclassified and reported in profit for the year		**–**	(1)
Net investment hedges			
– net fair value gains		**89**	106
– differences on exchange on borrowings		**(25)**	49
Tax on items that may be reclassified	6(d)	**(13)**	(36)
Items that will not be reclassified subsequently to profit or loss:		**355**	(306)
Retirement benefit schemes			
– net actuarial gains/(losses) in respect of subsidiaries	12	**308**	(381)
– surplus recognition and minimum funding obligations in respect of subsidiaries	12	**(5)**	60
– actuarial gains/(losses) in respect of associates net of tax	5	**90**	(39)
Tax on items that will not be reclassified	6(d)	**(38)**	54
Total other comprehensive income for the year, net of tax		**(670)**	(643)
Total comprehensive income for the year, net of tax		**3,529**	3,433
Attributable to:			
Owners of the parent		**3,272**	3,163
Non-controlling interests		**257**	270
		3,529	3,433

Prior year results have been restated with the adoption of the revised IAS 19 *Employee Benefits* as explained in note 12.

The accompanying notes are an integral part of the Group financial statements.

Group Statement of Changes in Equity
At 31 December

		Attributable to owners of the parent						
	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**
Balance at 1 January 2013		**507**	**3,916**	**796**	**2,253**	**7,472**	**307**	**7,779**
Total comprehensive income for the year (page 118)		**–**	**–**	**(986)**	**4,258**	**3,272**	**257**	**3,529**
Profit for the year		**–**	**–**	**–**	**3,904**	**3,904**	**295**	**4,199**
Other comprehensive income for the year		**–**	**–**	**(986)**	**354**	**(632)**	**(38)**	**(670)**
Employee share options								
– value of employee services		**–**	**–**	**–**	**61**	**61**	**–**	**61**
– proceeds from shares issued		**–**	**3**	**–**	**1**	**4**	**–**	**4**
Dividends and other appropriations								
– ordinary shares		**–**	**–**	**–**	**(2,611)**	**(2,611)**	**–**	**(2,611)**
– to non-controlling interests		**–**	**–**	**–**	**–**	**–**	**(271)**	**(271)**
Purchase of own shares								
– held in employee share ownership trusts		**–**	**–**	**–**	**(74)**	**(74)**	**–**	**(74)**
– share buy-back programme		**–**	**–**	**–**	**(1,509)**	**(1,509)**	**–**	**(1,509)**
Non-controlling interests – capital injection	26(b)	**–**	**–**	**–**	**–**	**–**	**8**	**8**
Other movements		**–**	**–**	**–**	**19**	**19**	**–**	**19**
Balance at 31 December 2013		**507**	**3,919**	**(190)**	**2,398**	**6,634**	**301**	**6,935**

		Attributable to owners of the parent						
	Notes	Share capital £m	Share premium, capital redemption and merger reserves £m	Other reserves £m	Retained earnings Restated £m	Total attributable to owners of parent Restated £m	Non-controlling interests Restated £m	Total equity Restated £m
Balance at 1 January 2012		506	3,913	1,112	2,636	8,167	307	8,474
Total comprehensive income for the year (page 118)		–	–	(316)	3,479	3,163	270	3,433
Profit for the year		–	–	–	3,797	3,797	279	4,076
Other comprehensive income for the year		–	–	(316)	(318)	(634)	(9)	(643)
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

Prior year results have been restated with the adoption of the revised IAS 19 *Employee Benefits* as explained in note 12.

The accompanying notes are an integral part of the Group financial statements.

Group Balance Sheet
At 31 December

	Notes	2013 £m	2012 £m
Assets			
Non-current assets			
Intangible assets	9	**11,205**	11,710
Property, plant and equipment	10	**3,156**	3,201
Investments in associates and joint ventures	11	**2,299**	2,330
Retirement benefit assets	12	**135**	105
Deferred tax assets	13	**248**	327
Trade and other receivables	14	**171**	224
Available-for-sale investments	15	**36**	37
Derivative financial instruments	16	**113**	207
Total non-current assets		**17,363**	18,141
Current assets			
Inventories	17	**4,042**	4,026
Income tax receivable	18	**95**	83
Trade and other receivables	14	**2,876**	2,741
Available-for-sale investments	15	**54**	26
Derivative financial instruments	16	**312**	166
Cash and cash equivalents	19	**2,106**	2,081
		9,485	9,123
Assets classified as held-for-sale	26(e)	**33**	63
Total current assets		**9,518**	9,186
Total assets		**26,881**	27,327

Group Balance Sheet
continued

	Notes	2013 £m	2012 £m
Equity			
Capital and reserves			
Share capital		**507**	507
Share premium, capital redemption and merger reserves		**3,919**	3,916
Other reserves		**(190)**	796
Retained earnings		**2,398**	2,253
Owners of the parent		**6,634**	7,472
after deducting			
– cost of treasury shares		**(4,325)**	(2,824)
Non-controlling interests		**301**	307
Total equity	20	**6,935**	7,779
Liabilities			
Non-current liabilities			
Borrowings	21	**9,716**	9,083
Retirement benefit liabilities	12	**632**	1,152
Deferred tax liabilities	13	**514**	500
Other provisions for liabilities and charges	22	**387**	419
Trade and other payables	23	**131**	166
Derivative financial instruments	16	**130**	86
Total non-current liabilities		**11,510**	11,406
Current liabilities			
Borrowings	21	**1,980**	1,636
Income tax payable	18	**487**	404
Other provisions for liabilities and charges	22	**194**	210
Trade and other payables	23	**5,741**	5,827
Derivative financial instruments	16	**34**	65
Total current liabilities		**8,436**	8,142
Total equity and liabilities		**26,881**	27,327

The accompanying notes are an integral part of the Group financial statements.

On behalf of the Board

Richard Burrows
Chairman

26 February 2014

Group Cash Flow Statement
For the year ended 31 December

	Notes	**2013** **£m**	2012 £m
Cash flows from operating activities			
Cash generated from operations	25	**5,366**	5,437
Dividends received from associates		**510**	486
Tax paid		**(1,440)**	(1,496)
Net cash generated from operating activities		**4,436**	4,427
Cash flows from investing activities			
Interest received		**70**	72
Dividends received from investments		**2**	2
Purchases of property, plant and equipment	25	**(574)**	(664)
Proceeds on disposal of property, plant and equipment	25	**173**	56
Purchases of intangibles		**(147)**	(140)
Purchases and proceeds on disposals of investments	25	**(32)**	24
Proceeds from associate's share buy-backs	25	**189**	262
Purchase of subsidiaries	25	**(16)**	(12)
Net cash used in investing activities		**(335)**	(400)
Cash flows from financing activities			
Interest paid		**(570)**	(564)
Interest element of finance lease rental payments		**(1)**	(1)
Capital element of finance lease rental payments		**(2)**	(5)
Proceeds from issue of shares to owners of the parent		**3**	4
Proceeds from the exercise of options over own shares held in employee share ownership trusts		**1**	1
Proceeds from increases in and new borrowings	25	**2,428**	2,539
Movements relating to derivative financial instruments	25	**54**	93
Purchases of own shares		**(1,509)**	(1,258)
Purchases of own shares held in employee share ownership trusts		**(74)**	(121)
Purchases of non-controlling interests	25	**–**	(24)
Reductions in and repayments of borrowings	25	**(1,421)**	(1,821)
Dividends paid to owners of the parent	8	**(2,611)**	(2,538)
Dividends paid to non-controlling interests		**(265)**	(259)
Net cash used in financing activities		**(3,967)**	(3,954)
Net cash flows generated from operating, investing and financing activities		**134**	73
Differences on exchange		**(197)**	(176)
Decrease in net cash and cash equivalents in the year		**(63)**	(103)
Net cash and cash equivalents at 1 January		**1,839**	1,942
Net cash and cash equivalents at 31 December	19	**1,776**	1,839

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.

With effect from 1 January 2013 the Group has adopted the revised IAS 19 *Employee Benefits*. The revised standard has not changed the values of retirement benefit assets and liabilities on the balance sheet, but has changed the amounts recognised in the income statement and in other comprehensive income. The expected return on scheme assets and the interest cost on liabilities have been replaced by a new component of the income statement charge – interest on the net retirement benefit asset/liability. The revised standard has retrospective application and has reduced the profit for the year to 31 December 2012 by £46 million, with compensating credits in other comprehensive income, as is shown in note 12.

The Group has early adopted IFRS 10 *Consolidated Financial Statements*, IFRS 11 *Joint Arrangements* and IFRS 12 *Disclosure of Interests in Other Entities* with effect from 1 January 2013 along with the revised versions of IAS 27 *Separate Financial Statements* and IAS 28 *Associates*. IAS 31 *Joint Ventures* has been withdrawn by the IASB. These standards form a single package of proposals with mandatory application in the EU from 1 January 2014. The aim of these standards is to improve the quality of reporting in relation to the consolidation of subsidiaries, special purpose vehicles and accounting for joint arrangements. While the requirements of IFRS 12 has lengthened certain disclosures in respect of Group entities, the requirements of these standards have not materially affected the Group.

In addition, with effect from 1 January 2013 the Group has adopted a number of minor changes to IFRS including the amendment to IAS 1 *Presentation of Financial Statements* which changes the presentation of certain items within other comprehensive income grouping them into items which recycle to profit and loss and items which will not, and IFRS 13 *Fair Value Measurement* which provides a single source of fair value measurement and disclosure requirements for use across IFRS. The implementation of IFRS 13 does not require a restatement of historical transactions.

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, 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 2013 and 2012 are described in note 26;
- the review of applicable exchange rates for transactions with and translation of entities in territories where there are restrictions on the free access to foreign currency, or multiple exchange rates; and
- the exemptions taken under IFRS 1 on the first time adoption of IFRS at 1 January 2004 and, in particular, those relating to goodwill on business combinations which are explained in the accounting policies below.

Such estimates and assumptions are based on historical experience and various other factors that are believed to be reasonable in the circumstances and constitute management's best judgement at the date of the financial statements. In the future, actual experience may deviate from these estimates and assumptions, which could affect the financial statements as the original estimates and assumptions are modified, as appropriate, in the year in which the circumstances change.

Basis of consolidation

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

A subsidiary is an entity controlled by the Group. The Group controls an entity when the Group is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity.

Notes on the accounts
continued

1 Accounting policies continued

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

Joint arrangements comprise contractual arrangements where two or more parties have joint control and where decisions regarding the relevant activities of the entity require unanimous consent. Joint operations are jointly-controlled arrangements where the parties to the arrangement have rights to the underlying assets and obligations for the underlying liabilities relating to the arrangement. The Group accounts for its share of the assets, liabilities, income and expenses of any such arrangement. Joint ventures comprise arrangements where the parties to the arrangement have rights to the net assets of the arrangement. They are accounted for using the equity method.

The results of subsidiary undertakings acquired during the period are included from the date of acquisition of a controlling interest at which date, for the purposes of consolidation, the purchase consideration is allocated between the underlying net assets acquired, including intangible assets other than goodwill, on the basis of their fair value. Acquisition related costs are expensed as incurred. Similarly, the results of associates and joint arrangements are included from the date of acquiring significant influence or joint control respectively.

The results of subsidiary undertakings, associates and joint arrangements which have been sold during the year are included up to the date of disposal. The profit or loss on sale is calculated by reference to the net asset value at the date of disposal, adjusted for purchased goodwill previously consolidated in the balance sheet.

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

Foreign currencies

The functional currency of the Parent Company is sterling and this is also the presentation currency of the Group. The income and cash flow statements of Group undertakings expressed in currencies other than sterling are translated to sterling using exchange rates applicable to the dates of the underlying transactions. Average rates of exchange in each year are used where the average rate approximates the relevant exchange rate at the date of the underlying transactions. Assets and liabilities of Group undertakings are translated at the applicable rates of exchange at the end of each year. In territories where there are restrictions on the free access to foreign currency or multiple exchange rates, the applicable rates of exchange are regularly reviewed.

For hyperinflationary countries, the financial statements in local currency are adjusted to reflect the impact of local inflation prior to translation into sterling.

The differences between retained profits of overseas subsidiary undertakings, associates and joint arrangements translated at average and closing rates of exchange are taken to reserves, as are differences arising on the retranslation to sterling (using closing rates of exchange) of overseas net assets at the beginning of the year. Any differences that have arisen since 1 January 2004 are presented as a separate component of equity. As permitted under IFRS 1, any differences prior to that date are not included in this separate component of equity.

Where a disposal of an investment in a Group undertaking results in a loss of control of a subsidiary undertaking, the loss of significant influence over an associated company or the loss of joint control over a joint arrangement, the cumulative amount of the related foreign exchange differences deferred in the separate component of equity are recognised in the income statement when the gain or loss on disposal is recognised. These related exchange differences comprise the exchange differences on all amounts deemed to be part of the net investment in the undertaking, which are recycled to the income statement when a disposal occurs. For partial disposals of subsidiary undertakings the related exchange differences are reclassified within equity. For all other partial disposals the proportional share of the related exchange differences is recycled to the income statement.

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

Revenue

Revenue principally comprises sales of cigarettes, 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 recognised immediately.

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, net interest on the net defined benefit liability or asset, 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.

1 Accounting policies continued

Share-based payments

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

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

Research and development

Research expenditure is charged to income in the year in which it is incurred. Development expenditure is charged to income in the year it is incurred, unless it meets the recognition criteria of IAS 38 *Intangible Assets*.

Taxation

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

The current income tax charge is calculated on the basis of tax laws enacted or substantially enacted at the balance sheet date in the countries where the Group's subsidiaries, associates and joint arrangements operate and generate taxable income.

Deferred taxation is provided in full using the liability method for temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and the amount used for taxation purposes. Deferred tax is provided on temporary differences arising on investments in Group undertakings, except where the timing of the reversal of the temporary difference is controlled by the Group and it is probable that it will not reverse in the foreseeable future. A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. As required under IAS 12 *Income Taxes*, deferred tax assets and liabilities are not discounted.

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

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

The Group has exposures in respect of the payment or recovery of a number of taxes. Liabilities or assets for these payments or recoveries are recognised at such time as an outcome becomes probable and when the amount can reasonably be estimated.

Goodwill

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

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

The Group's policy up to and including 1997 was to eliminate goodwill against reserves. Goodwill acquired from 1998 to 31 December 2003 was capitalised and amortised over its useful economic life.

As permitted under IFRS 1, 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 10 years.

The investments in associates and joint ventures shown in the Group Balance Sheet include trademarks arising from the combination of Brown & Williamson (B&W) and R J Reynolds (RJR) in 2004 to form Reynolds American Inc. (RAI), as well as those arising on the acquisition of Conwood by RAI in 2006. As the combination of B&W and RJR for the Group involved the partial disposal of B&W and an investment in RAI, fair values were assigned to trademarks formerly owned by RJR but not to those formerly owned by B&W. Most of the carrying value of the trademarks relates to trademarks which are deemed to have indefinite lives and each trademark is subject to an annual impairment test. Certain minor trademarks are being amortised over their remaining lives.

Notes on the accounts
continued

1 Accounting policies continued

Property, plant and equipment

Property, plant and equipment are stated at cost less accumulated depreciation and impairment. Depreciation is calculated on a straight-line basis to write off the assets over their useful economic life. No depreciation is provided on freehold land or assets classified as held-for-sale. Freehold and leasehold property are depreciated at rates between 2.5% and 4% per annum, and plant and equipment at rates between 7% and 25% per annum.

Capitalised interest

Borrowing costs which are directly attributable to the acquisition, construction or production of intangible assets or plant, property and equipment that takes a substantial period of time to get ready for its intended use or sale, and for which the commencement date for capitalisation was on or after 1 January 2009, are capitalised as part of the cost of the asset, in accordance with IAS 23 *Borrowing Costs*. The Group's previous policy was to expense such borrowing costs as they were incurred.

Leased assets

Assets where the Group has substantially all the risks and rewards of ownership of the leased asset are classified as finance leases and are included as part of property, plant and equipment. Finance lease assets are initially recognised at an amount equal to the lower of their fair value and the present value of the minimum lease payments at inception of the lease, then depreciated over the shorter of the lease term and their estimated useful lives. Leasing payments consist of capital and finance charge elements and the finance element is charged to the income statement.

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

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

Impairment of non-financial assets

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

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

Impairment of financial assets

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

Inventories

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

Financial instruments

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

Financial assets and financial liabilities are initially recognised at fair value, plus directly attributable transaction costs where applicable, with subsequent measurement as set out below.

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

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

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

Cash and cash equivalents: cash and cash equivalents include cash in hand and deposits held on call, together with other short-term highly liquid investments including investments in certain money market funds. Cash equivalents normally comprise instruments with maturities of three months or less at date of acquisition. In the cash flow statement, cash and cash equivalents are shown net of bank overdrafts, which are included as current borrowings in the liabilities section on the balance sheet.

1 Accounting policies continued

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.

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.

Notes on the accounts
continued

1 Accounting policies continued

Segmental analysis

The Group is organised and managed on the basis of its geographic regions. These are the reportable segments for the Group as they form the focus of the Group's internal reporting systems and are the basis used by the chief operating decision maker, identified as the Management Board, for assessing performance and allocating resources.

The Group is primarily a single product business providing cigarettes and other tobacco products. While the Group has clearly differentiated brands, global segmentation between a wide portfolio of brands is not part of the regular internally reported financial information. The results of next-generation products are not currently material to the Group.

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

Adjusting items

Adjusting items are significant items in the profit from operations, net finance costs, taxation and the Group's share of the post-tax results of associates and joint ventures which individually or, if of a similar type, in aggregate, are relevant to an understanding of the Group's underlying financial performance. While the disclosure of adjusting items is not required by IFRS, these items are separately disclosed either as memorandum information on the face of the income statement and in the segmental analyses, or in the notes to the accounts as appropriate.

The Group believes that these items are useful to users of the Group financial statements in helping them to understand the underlying business performance and are used to derive the Group's principal non-GAAP measures of adjusted profit from operations and adjusted diluted earnings per share.

Provisions

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

Contingent liabilities and contingent assets

Subsidiaries and associates companies are defendants in tobacco-related and other litigation. Provision for this litigation 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.

IFRS 9 *Financial Instruments* has been issued covering the first and third phases of the IASB's project to replace IAS 39 *Financial Instruments: Recognition and Measurement*. In its current form, it sets out requirements for the classification and measurement of financial assets and financial liabilities, as well as introducing a new model for general hedge accounting.

- 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 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 requirements for general hedge accounting seek to better align hedge accounting with the risk management activities of an entity by removing or amending some of the rules within IAS 39. While the flexibility within the new requirements might allow companies to apply hedge accounting where previously they would not have been able to, the Group does not anticipate any material changes arising from these requirements.

The effect of applying the standard in its current form is therefore 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 phase of the project, covering impairment, will be assessed when the IASB has finalised the proposed requirements. A mandatory implementation date for IFRS 9 has not been set by the IASB, but in any event the Standard 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.

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 currently not 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 joint operations, and adjusted post-tax results of associates and joint ventures at constant rates of exchange. The constant rate comparison provided for reporting segment information is based on a retranslation, at prior year exchange rates, of the current year results of the Group'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 2013 segmental results were translated using the 2012 rates of exchange. The 2012 figures are also stated at the 2012 rates of exchange.

The analyses of revenue for the 12 months to 31 December 2013 and 31 December 2012, based on location of sales, are as follows:

			2013	2012
	Revenue Constant rates £m	**Translation exchange £m**	**Revenue Current rates £m**	Revenue £m
Asia-Pacific	**4,448**	**(245)**	**4,203**	4,214
Americas	**3,579**	**(262)**	**3,317**	3,460
Western Europe	**3,493**	**142**	**3,635**	3,442
EEMEA	**4,302**	**(197)**	**4,105**	4,074
Revenue	**15,822**	**(562)**	**15,260**	15,190

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:

					2013			2012
	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 Restated £m	Adjusting items £m	Segment result Restated £m
Asia-Pacific	**1,787**	**(94)**	**1,693**	**(21)**	**1,672**	1,663	(80)	1,583
Americas	**1,453**	**(89)**	**1,364**	**(61)**	**1,303**	1,391	(64)	1,327
Western Europe	**1,222**	**51**	**1,273**	**(140)**	**1,133**	1,175	(99)	1,076
EEMEA	**1,579**	**(89)**	**1,490**	**(72)**	**1,418**	1,412	(26)	1,386
Profit from operations	**6,041**	**(221)**	**5,820**	**(294)**	**5,526**	5,641	(269)	5,372
Net finance costs					**(466)**			(456)
Asia-Pacific	**293**	**(21)**	**272**	**22**	**294**	245	20	265
Americas	**439**	**6**	**445**	**(6)**	**439**	434	(25)	409
EEMEA	**6**	**–**	**6**	**–**	**6**	2	–	2
Share of post-tax results of associates and joint ventures	**738**	**(15)**	**723**	**16**	**739**	681	(5)	676
Profit before taxation					**5,799**			5,592

* 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(g) and in note 5, respectively.

Notes on the accounts
continued

2 Segmental analyses continued

Adjusted profit from operations at constant rates of £6,041 million (2012: £5,641 million) excludes certain depreciation, amortisation and impairment charges as explained in notes 3(b), 3(e) and 3(f). These are excluded from segmental profit from operations at constant rates as follows:

	2013					2012		
	Adjusted depreciation, amortisation and impairment Constant rates £m	**Translation exchange £m**	**Adjusted depreciation, amortisation and impairment Current rates £m**	**Adjusting items £m**	**Depreciation, amortisation and impairment Current rates £m**	Adjusted depreciation, amortisation and impairment £m	Adjusting items £m	Depreciation, amortisation and impairment £m
Asia-Pacific	**91**	**(1)**	**90**	**17**	**107**	89	22	111
Americas	**100**	**(4)**	**96**	**17**	**113**	104	25	129
Western Europe	**98**	**4**	**102**	**37**	**139**	92	34	126
EEMEA	**108**	**(4)**	**104**	**14**	**118**	101	8	109
	397	**(5)**	**392**	**85**	**477**	386	89	475

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	**2013 £m**	2012 £m	**2013 £m**	2012 £m	**2013 £m**	2012 £m
External revenue	**155**	139	**15,105**	15,051	**15,260**	15,190

	United Kingdom		All foreign countries		Group	
	2013 £m	2012 £m	**2013 £m**	2012 £m	**2013 £m**	2012 £m
Intangible assets	**417**	306	**10,788**	11,404	**11,205**	11,710
Property, plant and equipment	**357**	375	**2,799**	2,826	**3,156**	3,201
Investments in associates and joint ventures	**–**	–	**2,299**	2,330	**2,299**	2,330

The only foreign operation requiring separate disclosure under the requirements of IFRS 8 *Operating Segments* is Souza Cruz operating in Brazil. The results of Souza Cruz are not disclosed separately in this Segmental analysis as they are disclosed in note 31 due to the materiality of the non-controlling interests. The main acquisitions comprising the goodwill balance of £10,249 million (2012: £10,793 million), included in intangible assets, are provided in note 9. Included in investments in associates and joint ventures are amounts of £1,447 million (2012: £1,496 million) attributable to the investment in Reynolds American and £808 million (2012: £793 million) attributable to the investment in ITC. Further information can be found in note 11.

3 Profit from operations

(a) Employee benefit costs

	2013 £m	2012 Restated £m
Wages and salaries	**1,914**	1,907
Social security costs	**234**	257
Other pension and retirement benefit costs (note 12)	**162**	171
Share-based payments – equity-settled (note 27)	**61**	73
Share-based payments – cash-settled (note 27)	**13**	18
	2,384	2,426

(b) Depreciation, amortisation and impairment costs

		2013 £m	2012 £m
Intangibles	– amortisation of trademarks and similar intangibles (note 3(f))	**74**	63
	– amortisation of other intangibles	**48**	53
Property, plant and equipment	– depreciation	**321**	347
	– impairment	**34**	12
		477	475

Impairment in respect of certain property, plant and equipment is included in restructuring costs (see note 3(e)).

(c) Other operating income

This represents operating income arising from the Group’s activities which falls outside the definition of revenue and includes gains as a result of property disposals, service fees and other shared costs charged to third parties, manufacturing fees and trademark income.

Notes on the accounts
continued

3 Profit from operations continued

(d) Other operating expenses include:

	2013 **£m**	2012 £m
Research and development expenses (excluding employee benefit costs and depreciation)	**91**	93
Exchange differences	**11**	50
Rent of plant and equipment (operating leases)		
– minimum lease payments	**38**	41
Rent of property (operating leases)		
– minimum lease payments	**81**	75
Fees payable for audit services pursuant to legislation:		
– fees payable to PricewaterhouseCoopers LLP for Parent Company and Group audit	**1.8**	1.8
– fees payable to other PricewaterhouseCoopers firms and associates for local statutory and Group reporting audits	**7.6**	7.7
Audit fees payable to PricewaterhouseCoopers firms and associates	**9.4**	9.5
Audit fees payable to other firms	**0.5**	0.5
Total audit fees payable	**9.9**	10.0
Fees payable to PricewaterhouseCoopers firms and associates for other services:		
– audit-related assurance services	**0.3**	1.0
– other assurance services	**0.1**	0.2
– tax advisory services	**2.9**	2.5
– tax compliance	**1.0**	0.9
– other non-audit services	**0.6**	0.5
	4.9	5.1

The total fees payable to PricewaterhouseCoopers firms and associates included above are £14.3 million (2012: £14.6 million).

Total research and development costs including employee benefit costs and depreciation are £161 million (2012: £171 million).

(e) Restructuring and integration costs

Restructuring costs reflect the costs incurred as a result of initiatives to improve the effectiveness and the efficiency of the Group as a globally integrated enterprise, including the relevant operating costs of implementing the new operating model. The new operating model includes revised organisation structures, standardised processes and shared back office services underpinned by a global single instance of SAP. The new organisation structures and processes are currently being implemented and the deployment of the new SAP system started in the third quarter of 2012 and will take around a total of four years to fully roll-out. These initiatives also include a review of the Group's manufacturing operations, supply chain, overheads and indirect costs, organisational structure and systems and software used. The costs of these initiatives together with the costs of integrating acquired businesses into existing operations, including acquisition costs, are included in profit from operations under the following headings:

	2013 **£m**	2012 £m
Employee benefit costs	**140**	96
Depreciation and impairment costs	**11**	26
Other operating expenses	**161**	100
Other operating income	**(66)**	(16)
	246	206

3 Profit from operations continued

Restructuring and integration costs in 2013 principally relate to the restructuring initiatives directly related to implementation of a new operating model and the continuation of the factory closure and downsizing activities in Australia and Russia, and restructuring of factories in Kinshasa, Democratic Republic of the Congo; Boncourt, Switzerland and Bayreuth, Germany. The costs also cover separation packages in respect of permanent headcount reductions and permanent employee benefit reductions in the Group.

Restructuring and integration costs in 2012 principally related 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 included separation packages in respect of permanent headcount reductions and permanent employee benefit reductions in the Group.

Other operating income in 2013 includes gains from the sale of land and buildings in Australia, Denmark and Russia. In 2012, other operating income 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.

(f) Amortisation of trademarks and similar intangibles

The acquisitions of Protabaco, Bentoel, Tekel, ST and CN Creative Limited (see note 26(c)) as well as the creation of CTBAT International Limited (see note 26(a)) resulted in the capitalisation of trademarks and similar intangibles which are amortised over their expected useful lives, which do not exceed 20 years. The amortisation charge of £74 million (2012: £63 million) is included in depreciation, amortisation and impairment costs in profit from operations.

(g) Gain on deemed partial disposal of a trademark

The contribution of the State Express 555 brand to CTBAT International Limited (see note 26(a)) is accounted for at fair value in the arrangement. This resulted in a £26 million gain on a deemed partial disposal of a trademark which is included in other operating income but has been treated as an adjusting item.

Notes on the accounts
continued

4 Net finance costs

	2013 £m	2012 £m
Finance costs		
– interest payable		
– bank borrowings	**70**	83
– finance leases	**1**	1
– facility fees	**7**	10
– other	**536**	486
	614	580
– fair value changes on derivative financial instruments	**(103)**	(71)
– exchange differences on financial liabilities	**21**	(4)
	532	505
Finance income		
– interest and dividend income		
– gains in respect of available-for-sale investments	**–**	(1)
– dividend income in respect of available-for-sale investments	**(2)**	(2)
– other interest income	**(62)**	(81)
	(64)	(84)
– exchange differences on financial assets	**(2)**	35
	(66)	(49)
Net finance costs	**466**	456

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.

Fair value changes		
– cash flow hedges transferred from equity	**(6)**	35
– fair value hedging instruments – exchange related movements	**(4)**	3
– fair value hedging instruments – net interest income	**(90)**	(66)
– fair value hedging instruments – interest related movements *(note (i))*	**146**	(29)
– fair value changes on hedged items – interest related movements *(note (i))*	**(151)**	31
– instruments held-for-trading *(note (ii))*	**2**	(45)
	(103)	(71)
Finance costs – exchange differences on financial liabilities	**21**	(4)
Finance income – exchange differences on financial assets	**(2)**	35
	(84)	(40)

Notes:

(i) Hedge ineffectiveness in respect of fair value hedges is a £5 million gain (2012: £2 million loss) being the difference between the two items above.

(ii) IFRS requires derivatives which do not meet the tests for hedge accounting under IAS 39 to be classified as instruments held-for-trading with fair value changes included in the income statement. These derivatives principally consist of forward foreign currency contracts which have not been designated as hedges due to their fair value changes offsetting with other components of net finance costs relating to financial assets and liabilities.

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 (2012: £2 billion and US$150 million).

Exchange differences in respect of hedged items subject to fair value hedges and cash flow hedges were a loss of £4 million (2012: £3 million gain) and a loss of £14 million (2012: £28 million gain) respectively and are included in 'Finance costs – exchange differences' in the table above.

5 Associates and joint ventures

	2013		2012 Restated	
	Total £m	**Group's share £m**	Total £m	Group's share £m
Gross turnover (including duty, excise and other taxes)	**13,095**	**4,891**	12,733	4,798
Duty, excise and other taxes	**(3,961)**	**(1,485)**	(3,927)	(1,488)
Revenue	**9,134**	**3,406**	8,806	3,310

Profit from operations	**3,247**	**1,203**	2,917	1,086
Net finance costs	**(174)**	**(73)**	(160)	(66)
Profit on ordinary activities before taxation	**3,073**	**1,130**	2,757	1,020
Taxation on ordinary activities	**(1,037)**	**(387)**	(911)	(341)
Profit on ordinary activities after taxation	**2,036**	**743**	1,846	679
Non-controlling interests	**(11)**	**(4)**	(9)	(3)
Post-tax results of associates and joint ventures	**2,025**	**739**	1,837	676

Analysed as:				
– adjusted share of post-tax results of associates and joint ventures	**1,966**	**723**	1,829	681
– issue of shares and change in shareholding	**73**	**22**	66	20
– restructuring and integration costs	**(10)**	**(4)**	(57)	(24)
– other	**(4)**	**(2)**	(1)	(1)
	2,025	**739**	1,837	676

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 2013, the Group's interest in ITC Ltd. (ITC) decreased from 30.72% to 30.47% 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 £22 million, which is treated as a deemed partial disposal and included in the income statement.

During the year, Reynolds American Inc. (RAI) recognised restructuring charges of US$24 million in respect of its overall activities. The Group's share of these charges is £4 million (net of tax).

RAI has also recognised amounts which have been combined in the table of adjusting items in the Group income statement and are shown as 'other'. These include costs of US$18 million in respect of a number of Engle progeny lawsuits, the Group's share of which is £3 million (net of tax); costs of US$34 million relating to other tobacco-related litigation charges, the Group's share of which is £6 million (net of tax); trademark amortisation and impairment of US$27 million, the Group's share of which is £4 million (net of tax); and costs of US$124 million relating to losses on extinguishment of debt, the Group's share of which is £22 million (net of tax). In addition, during 2013, RAI, various other tobacco manufacturers, 19 states, the District of Columbia and Puerto Rico reached a final agreement related to RAI's 2003 Master Settlement Agreement (MSA) activities. Under this agreement RAI will receive credits, currently estimated to be more than US$1 billion, in respect of its Non-Participating Manufacturer (NPM) Adjustment claims related to the period from 2003 to 2012. These credits will be applied against the company's MSA payments over the next five years, subject to meeting the various ongoing performance obligations. During 2013, RAI has recognised income of US$219 million related to its 2012 liability, the Group's share of which is £33 million (net of tax). Credits claimable against 2013 and future years would be accounted for in the applicable year and will not be treated as adjusting items.

Notes on the accounts
continued

5 Associates and joint ventures continued

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. This resulted in a gain of £20 million, which was treated as a deemed partial disposal and included in the income statement.

During 2012, RAI recognised restructuring charges of US$149 million and the Group's share of these charges amounted to £24 million (net of tax).

In the year ended 31 December 2012, RAI 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 which amounted to £6 million (net of tax); and trademark amortisation and impairment of US$86 million, the Group's share of which amounted to £16 million (net of tax). These charges were offset by a gain of US$157 million resulting from the amendment by RAI of a post-employment medical plan, the Group's share of which amounted to £24 million (net of tax).

	2013	2012 Restated
	Group's share £m	Group's share £m
Profit on ordinary activities after taxation		
– attributable to owners of the Parent	**739**	676
Other comprehensive income:		
Differences on exchange	**(141)**	(145)
Net fair value losses on available-for-sale investments	**(7)**	(4)
Actuarial gains/(losses) relating to pensions and other post-retirement benefits (note 20)	**90**	(39)
Total comprehensive income (note 11)	**681**	488

	2013	2012
	Group's share £m	Group's share £m
Dividends received		
– listed investments	**504**	476
– unlisted investments	**8**	11
Total dividends received from associates	**512**	487

Summarised financial information of the Group's associates and joint ventures:

			2013			2012 Restated
	RAI £m	**ITC £m**	**Others £m**	RAI £m	ITC £m	Others £m
Revenue	**5,268**	**3,557**	**309**	5,235	3,327	244
Profit on ordinary activities before taxation	**1,648**	**1,358**	**67**	1,500	1,212	45
Post-tax results of associates and joint ventures	**1,035**	**942**	**48**	967	837	33
Other comprehensive income	**130**	**(454)**	**34**	(206)	(228)	2
Total comprehensive income	**1,165**	**488**	**82**	761	609	35

6 Taxation on ordinary activities

(a) Summary of taxation on ordinary activities

	2013 £m	2012 Restated £m
UK corporation tax	–	–
Overseas tax	**1,567**	1,538
Comprising:		
– current year tax expense	**1,581**	1,556
– adjustments in respect of prior periods	**(14)**	(18)
Total current tax	**1,567**	1,538
Deferred tax	**33**	(22)
Comprising:		
– deferred tax relating to origination and reversal of temporary differences	**33**	(22)
	1,600	1,516

(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.

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 a full quantification hearing is scheduled for May 2014.

No potential receipt has been recognised in the current period or the prior year, in the results of the Group, due to the uncertainty of the amounts and eventual outcome.

Notes on the accounts
continued

6 Taxation on ordinary activities continued

(c) Factors affecting the taxation charge

The taxation charge differs from the standard 23% (2012: 24%) rate of corporation tax in the UK. The major causes of this difference are listed below:

	2013		2012 Restated	
	£m	**%**	£m	%
Profit before tax	**5,799**		5,592	
Less: share of post-tax results of associates and joint ventures	**(739)**		(676)	
	5,060		4,916	
Tax at 23% (2012: 24%) on the above	**1,164**	**23.0**	1,180	24.0
Factors affecting the tax rate:				
Tax at standard rates other than UK corporation tax rate	**158**	**3.1**	128	2.6
Other national tax charges	**51**	**1.0**	76	1.5
Permanent differences	**6**	**0.1**	24	0.5
Overseas withholding taxes	**138**	**2.7**	172	3.5
Double taxation relief on UK profits	**(11)**	**(0.2)**	(13)	(0.3)
Unutilised tax losses	**62**	**1.2**	–	–
Adjustments in respect of prior periods	**(14)**	**(0.2)**	(18)	(0.3)
Net deferred tax debits/(credits) at other tax rates	**46**	**0.9**	(33)	(0.7)
	1,600	**31.6**	1,516	30.8

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. This was treated as an adjusting item in the adjusted earnings per share calculation as set out in note 7.

(d) Tax on items recognised directly in other comprehensive income

	2013 £m	2012 Restated £m
Current tax	**2**	(2)
Deferred tax	**(53)**	20
(Charged)/credited to other comprehensive income	**(51)**	18

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 £3,904 million (2012: £3,797 million) and 1,901 million (2012: 1,939 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 1,908 million (2012: 1,949 million) to reflect the potential dilutive effect of employee share schemes.

	2013			2012 Restated		
	Earnings £m	**Weighted average number of shares m**	**Earnings per share pence**	Earnings Restated £m	Weighted average number of shares m	Earnings per share Restated pence
Basic earnings per share	**3,904**	**1,901**	**205.4**	3,797	1,939	195.8
Share options	**–**	**7**	**(0.8)**	–	10	(1.0)
Diluted earnings per share	**3,904**	**1,908**	**204.6**	3,797	1,949	194.8

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			
		2013		2012 Restated		**2013**		2012 Restated	
	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		**3,904**	**204.6**	3,797	194.8	**3,904**	**205.4**	3,797	195.8
Effect of restructuring and integration costs	3(e)	**246**	**12.9**	206	10.6	**246**	**12.9**	206	10.6
Tax and non-controlling interests on restructuring and integration costs		**(35)**	**(1.9)**	(45)	(2.3)	**(35)**	**(1.9)**	(45)	(2.3)
Effect of deferred tax liability credit	6(c)	**–**	**–**	(11)	(0.6)	**–**	**–**	(11)	(0.6)
Effect of amortisation of trademarks and similar intangibles	3(f)	**74**	**3.9**	63	3.2	**74**	**3.9**	63	3.3
Tax on amortisation of trademarks and similar intangibles		**(14)**	**(0.7)**	(15)	(0.8)	**(14)**	**(0.7)**	(15)	(0.8)
Gain on deemed partial disposal of a trademark	3(g)	**(26)**	**(1.4)**	–	–	**(26)**	**(1.4)**	–	–
Effect of associates' adjusting items net of tax	5	**(16)**	**(0.8)**	5	0.3	**(16)**	**(0.8)**	5	0.3
Adjusted earnings per share		**4,133**	**216.6**	4,000	205.2	**4,133**	**217.4**	4,000	206.3

Notes on the accounts
continued

7 Earnings per share continued

Headline earnings per share as required by the JSE Limited

The presentation of headline earnings per share, as an alternative measure of earnings per share, is mandated under the JSE Listing Requirements. It is calculated in accordance with Circular 2/2013 'Headline Earnings', as issued by the South African Institute of Chartered Accountants. Circular 2/2013 superseded Circular 3/2012 for reporting periods ending on or after 31 July 2013 and requires the comparative figures to be restated where appropriate. The headline earnings per share for 2012 have been restated for the effects of the revised IAS 19 *Employee Benefits* as explained in note 12. Headline earnings per share are calculated as shown below:

	Diluted				Basic			
	2013		2012 Restated		**2013**		2012 Restated	
	Earnings £m	**Earnings per share pence**	Earnings £m	Earnings per share pence	**Earnings £m**	**Earnings per share pence**	Earnings £m	Earnings per share pence
Unadjusted earnings per share	**3,904**	**204.6**	3,797	194.8	**3,904**	**205.4**	3,797	195.8
Effect of impairment of intangibles, and property, plant and equipment	**34**	**1.8**	12	0.6	**34**	**1.8**	12	0.6
Tax and non-controlling interests on impairment of intangibles, and property, plant and equipment	**(2)**	**(0.1)**	(4)	(0.2)	**(2)**	**(0.1)**	(4)	(0.2)
Effect of gains on disposal of property, plant and equipment and held-for-sale assets	**(92)**	**(4.8)**	(15)	(0.8)	**(92)**	**(4.8)**	(15)	(0.8)
Tax and non-controlling interests on disposal of property, plant and equipment and held-for-sale assets	**25**	**1.3**	–	–	**25**	**1.3**	–	–
Effect of disposal of businesses and trademarks	**(26)**	**(1.4)**	–	–	**(26)**	**(1.4)**	–	–
Effect of gains reclassified from the available-for-sale reserve	**(2)**	**(0.1)**	(1)	–	**(2)**	**(0.1)**	(1)	–
Share of associates' trademark and other asset impairments net of tax	**4**	**0.2**	15	0.8	**4**	**0.2**	15	0.8
Issue of shares and change in shareholding in associate	**(22)**	**(1.1)**	(20)	(1.0)	**(22)**	**(1.2)**	(20)	(1.0)
Headline earnings per share	**3,823**	**200.4**	3,784	194.2	**3,823**	**201.1**	3,784	195.2

8 Dividends and other appropriations

	2013		2012	
	Pence per share	**£m**	Pence per share	£m
Ordinary shares				
Interim				
2013 paid 30 September 2013	**45.0**	**846**		
2012 paid 26 September 2012			42.2	815
Final				
2012 paid 8 May 2013	**92.7**	**1,765**		
2011 paid 3 May 2012			88.4	1,723
	137.7	**2,611**	130.6	2,538

The Directors have recommended to shareholders a final dividend of 97.4p per share for the year ended 31 December 2013. If approved, this dividend will be paid to shareholders on 8 May 2014. 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 £1,838 million, which takes the total dividends declared in respect of 2013 to £2,684 million (2012: £2,580 million) representing 142.4p per share (2012: 134.9p 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 2013					
Cost	10,793	659	904	173	12,529
Accumulated amortisation and impairment		(509)	(310)		(819)
Net book value at 1 January 2013	10,793	150	594	173	11,710
Differences on exchange	(545)	(1)	(21)	(4)	(571)
Additions					
– internal development	–	14	–	133	147
– acquisitions (note 26)	1	–	25	–	26
– separately acquired	–	3	10	–	13
Reallocations	–	19	–	(19)	–
Amortisation charge	–	(50)	(70)	–	(120)
31 December 2013					
Cost	10,249	631	891	283	12,054
Accumulated amortisation and impairment		(496)	(353)		(849)
Net book value at 31 December 2013	10,249	135	538	283	11,205
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
– acquisitions (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

* The cost of Goodwill is shown net of impairment charges made in prior years.

Included in computer software and assets in the course of development are internally developed assets with a carrying value of £398 million (2012: £296 million). The costs of internally developed assets include capitalised expenses of employees working full time on software development projects, third-party consultants, as well as software licence fees from third-party suppliers.

Acquisitions in 2013 relate to the creation of CTBAT International Limited and the acquisition of British American Tobacco Myanmar Limited as explained in note 26. Acquisitions in 2012 relate to the acquisition of CN Creative Limited and an adjustment to the purchase price for Protabaco (acquired in 2011), as explained in note 26.

Included in the net book value of trademarks and similar intangibles are trademarks relating to the acquisition of Skandinavisk Tobakskompagni (ST) £301 million (2012: £322 million), Tekel £30 million (2012: £41 million), Bentoel £38 million (2012: £60 million) and Protabaco £91 million (2012: £112 million) and intellectual property of £26 million (2012: £40 million) relating to the acquisition of CN Creative Limited in 2012.

The Group has future contractual commitments of £11 million related to intangible assets.

Notes on the accounts
continued

9 Intangible assets continued

Impairment testing for intangible assets with indefinite lives including goodwill

Goodwill of £10,249 million (2012: £10,793 million) is included in intangible assets in the balance sheet of which the following are the significant acquisitions: Rothmans Group £4,542 million (2012: £4,796 million); Imperial Tobacco Canada £2,281 million (2012: £2,477 million); ETI (Italy) £1,371 million (2012: £1,337 million) and ST (principally Scandinavia) £1,030 million (2012: £1,004 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 2013 and 2012, goodwill was allocated for impairment testing purposes to 14 individual cash-generating units – five in Asia-Pacific, five in the Americas, two in Western Europe and two in EEMEA.

The carrying amounts of goodwill allocated to the cash-generating units of Canada £2,281 million (2012: £2,477 million), Western Europe (includes Rothmans and other acquisitions) £3,624 million (2012: £3,539 million), Eastern Europe (includes Rothmans and other acquisitions) £908 million (2012: £889 million), South Africa £639 million (2012: £803 million), Australia (includes Rothmans and other acquisitions) £724 million (2012: £856 million), Singapore £511 million (2012: £538 million) and Malaysia £434 million (2012: £474 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 14.1% (2012: 7.2% to 13.9%) were used, based on the Group's weighted average cost of capital, together with any premium applicable for economic and political risks.

The pre-tax discount rates used for the cash-generating units which are significant in comparison with the total carrying amount of goodwill are 8.5% for Canada (2012: 8.6%), 9.3% for Western Europe (2012: 9.3%), 8.6% for Eastern Europe (2012: 8.9%), 9.3% for South Africa (2012: 9.3%), 8.6% for Australia (2012: 8.6%), 7.2% for Singapore (2012: 7.2%) and 8.7% for Malaysia (2012: 8.7%).

If discounted cash flows for cash-generating units should fall by 10%, or the discount rate was increased at a post-tax rate of 1%, there would be no impairment.

10 Property, plant and equipment

	Freehold property £m	Leasehold property £m	Plant and equipment £m	Assets in the course of construction £m	Total £m
1 January 2013					
Cost	**1,138**	**261**	**4,453**	**483**	**6,335**
Accumulated depreciation and impairment	**(362)**	**(123)**	**(2,649)**		**(3,134)**
Net book value at 1 January 2013	**776**	**138**	**1,804**	**483**	**3,201**
Differences on exchange	**(47)**	**(6)**	**(137)**	**(37)**	**(227)**
Additions*	**12**	**16**	**117**	**420**	**565**
Reallocations	**24**	**(4)**	**314**	**(334)**	**–**
Depreciation	**(22)**	**(9)**	**(270)**	**–**	**(301)**
Impairment	**(2)**	**–**	**(14)**	**(17)**	**(33)**
Disposals	**(32)**	**–**	**(17)**	**–**	**(49)**
31 December 2013					
Cost	**1,034**	**258**	**4,257**	**527**	**6,076**
Accumulated depreciation and impairment	**(325)**	**(123)**	**(2,460)**	**(12)**	**(2,920)**
Net book value at 31 December 2013	**709**	**135**	**1,797**	**515**	**3,156**
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	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
Assets held under finance leases					
31 December 2013					
Cost			**13**		**13**
Accumulated depreciation and impairment			**(8)**		**(8)**
Net book value at 31 December 2013			**5**		**5**
31 December 2012					
Cost			18		18
Accumulated depreciation and impairment			(15)		(15)
Net book value at 31 December 2012			3		3

* Additions in 2013 include amounts contributed by the non-controlling interest in Myanmar (note 26).

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 subsidiary in Pakistan. Assets held under finance leases are secured under finance lease obligations included in note 21.

	2013 £m	2012 £m
Cost of freehold land within freehold property on which no depreciation is provided	**203**	226
Leasehold property comprises		
– net book value of long leasehold	**111**	105
– net book value of short leasehold	**24**	33
	135	138
Contracts placed for future expenditure	**82**	38

11 Investments in associates and joint ventures

	2013 £m	2012 £m
1 January	**2,330**	2,613
Total comprehensive income (note 5)	**681**	488
Dividends (note 5)	**(512)**	(487)
Share buy-backs (note 25(c))	**(189)**	(262)
Other equity movements	**(11)**	(22)
31 December	**2,299**	2,330
Non-current assets	**3,741**	3,815
Current assets	**1,667**	1,957
Non-current liabilities	**(1,983)**	(2,090)
Current liabilities	**(1,126)**	(1,352)
	2,299	2,330
Reynolds American Inc. (Group's share of market value of £6,828 million (2012: £5,925 million))	**1,447**	1,496
ITC Ltd. (Group's share of market value of £7,587 million (2012: £7,771 million))	**808**	793
Other listed associates (Group's share of market value of £83 million (2012: £109 million))	**11**	13
Unlisted	**33**	28
	2,299	2,330

11 Investments in associates and joint ventures continued

The principal associate undertakings of the Group are Reynolds American Inc. (RAI) and ITC Ltd (ITC) as shown under principal associate undertakings.

Reynolds American Inc.

	2013 £m	2012 £m
Non-current assets	4,146	4,224
Current assets	2,257	3,009
Non-current liabilities	(4,576)	(4,843)
Current liabilities	(1,739)	(2,250)
	88	140
Group's share of Reynolds American Inc. (42.0%)	37	59
Goodwill	1,410	1,437
Total Group's share of Reynolds American Inc.	**1,447**	1,496

The Group's share of RAI includes £446 million (2012: £461 million) of trademarks arising from the RAI transaction in 2004. In addition, the Group's share of non-current assets includes £628 million (2012: £640 million) of goodwill and £291 million (2012: £296 million) of trademarks arising from the acquisition of Conwood by RAI in 2006.

Details of the Group's contingent liabilities are set out in note 30. In addition to US litigation involving Group companies, which is covered by the R.J. Reynolds Tobacco Company (RJRT) indemnity referred to in note 30, RAI group companies are named in litigation which does not involve Group companies. While it is impossible to be certain of the outcome of any particular case or of the amount of any possible adverse verdict, it is not impossible that the results of operations or cash flows of RAI, in particular quarterly or annual periods, could be materially affected by this and by the final outcome of any particular litigation. However, having regard to the contingent liability disclosures on litigation made by RAI in its public financial reports, the Directors are satisfied with the carrying value included above for RAI.

The Group's share of the RAI results for the year to 31 December 2013 includes £43 million (2012: £41 million) in respect of external legal fees and other external product liability defence costs.

ITC Ltd.

ITC prepares accounts on a quarterly basis using a 31 March year end. As permitted by IAS 28, results as at 30 September 2013 have been used in applying the equity method, to be consistent with the treatment in the Group's interim accounts given the availability of information at the half year. Any further information available after the date used for reporting purposes is reviewed and any material items adjusted for in the final results. The latest published information available is at 31 December 2013.

	2013 £m	2012 £m
Non-current assets	1,858	1,891
Current assets	2,202	2,109
Non-current liabilities	(194)	(176)
Current liabilities	(1,214)	(1,243)
	2,652	2,581
Group's share of ITC Ltd. (2013: 30.47% (2012: 30.72%))	**808**	793

Additional information on associates is provided in the principal associate undertaking sections to the Annual Report.

Notes on the accounts
continued

12 Retirement benefit schemes

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

The liabilities arising in the defined benefit schemes are determined in accordance with the advice of independent, professionally qualified actuaries, using the projected unit credit method. All schemes are formally valued at least every three years.

The principal schemes are in the UK, Germany, Canada, the Netherlands and Switzerland. Together schemes in these territories account for over 85% of the total obligations of the Group's defined benefit schemes. These obligations consist mainly of final salary pension schemes which provide benefits to members in the form of a guaranteed level of pension payable for life. The level of benefits provided depends on members' length of service and their salary in the final years leading up to retirement. In addition, the Group operates several healthcare benefit schemes, of which the most significant are in Canada. The liabilities in respect of healthcare benefits are also assessed by qualified independent actuaries, applying the projected unit credit method.

All of these arrangements, including funding arrangements where formal trusts or equivalents are required, have been developed and are operated in accordance with local regulations and practices in the countries concerned. Responsibility for the governance of the schemes, including investment decisions and contribution schedules, lies with the trustees. The trustees for each arrangement will usually consist of representatives appointed by both the sponsoring company and the beneficiaries.

The majority of schemes are subject to local regulation regarding funding deficits. However, the scheme liabilities of the Group as measured for the purposes of determining funding levels are not considered to be materially different to the liabilities as measured under IAS 19.

The majority of benefit payments are from trustee administered funds; however, there are also a number of unfunded schemes where the sponsoring company meets the benefit payment obligation as it falls due.

While the funded arrangements in the Group have policies on investment management, including strategies over a preferred long-term investment profile, formal asset/liability matching plans are not common, although schemes in certain territories including Canada and the Netherlands manage their bond portfolios to match the weighted average duration of scheme liabilities. In addition, the main scheme in the UK has a target investment strategy such that, by 31 December 2018 the scheme will have moved to 20% return-seeking assets and 80% risk-reducing assets. Investments are diversified by type of investment, by investment sector, and where appropriate by country.

Through its defined benefit pension schemes and healthcare schemes, the Group is exposed to a number of risks, including:

Asset volatility: the plan liabilities are calculated using discount rates set by reference to bond yields; if plan assets underperform this yield e.g. due to stock market volatility, this will create a deficit. However, most schemes hold a proportion of assets which are expected to outperform bonds in the long term, and the majority of schemes by value are subject to local regulation regarding funding deficits.

Changes in bond yields: a decrease in corporate bond yields will increase scheme liabilities, although this will be partially offset by an increase in the value of the schemes' bond holdings.

Inflation risk: some of the Group's pension obligations are linked to inflation and higher inflation will lead to higher liabilities, although, in most cases, caps on the level of inflationary increases are in place in the scheme rules.

Life expectancy: the majority of the schemes' obligations are to provide benefits for the life of the member, so increases in life expectancy will result in an increase in the plans' liabilities. Assumptions regarding mortality and mortality improvements are regularly reviewed in line with actuarial tables and scheme specific experience.

As explained in note 1, with effect from 1 January 2013 the Group has adopted the revised IAS 19 *Employee Benefits*. The comparative figures for 2012 have been restated accordingly for the following changes:

	£m
Removal of expected return on assets	(284)
Recognition of interest on scheme assets	250
Recognition of interest on unrecognised scheme surpluses	(6)
Impact on profit from operations	(40)
Associates: adjustment for interest on scheme assets net of tax	(16)
Impact on taxation charge of subsidiaries (deferred tax)	10
Reduction in profit for the year	**(46)**
Adjustment for restated actuarial gains on scheme assets in respect of subsidiaries	34
Adjustment for restated surplus recognition and minimum funding obligations in respect of subsidiaries	6
Tax on items recognised directly in other comprehensive income	(10)
Net actuarial losses in respect of associates net of tax	16
Increase in other comprehensive income	**46**

As a result of the above, basic and diluted earnings per share for 2012 reduced from 198.1p to 195.8p and from 197.1p to 194.8p respectively.

12 Retirement benefit schemes continued

The amounts recognised in the balance sheet are determined as follows:

	Pension schemes		Healthcare schemes		Total	
	2013 £m	2012 £m	**2013 £m**	2012 £m	**2013 £m**	2012 £m
Present value of funded scheme liabilities	**(5,905)**	(6,196)	**(16)**	(21)	**(5,921)**	(6,217)
Fair value of funded scheme assets	**5,767**	5,547	**13**	16	**5,780**	5,563
	(138)	(649)	**(3)**	(5)	**(141)**	(654)
Unrecognised funded scheme surpluses	**(19)**	(15)	**–**	–	**(19)**	(15)
	(157)	(664)	**(3)**	(5)	**(160)**	(669)
Present value of unfunded scheme liabilities	**(239)**	(224)	**(98)**	(154)	**(337)**	(378)
	(396)	(888)	**(101)**	(159)	**(497)**	(1,047)

The above net liability is recognised in the balance sheet as follows:

– retirement benefit scheme liabilities	**(531)**	(993)	**(101)**	(159)	**(632)**	(1,152)
– retirement benefit scheme assets	**135**	105	**–**	–	**135**	105
	(396)	(888)	**(101)**	(159)	**(497)**	(1,047)

The amounts recognised in the income statement are as follows:

	Pension schemes		Healthcare schemes		Total	
	2013 £m	2012 Restated £m	**2013 £m**	2012 £m	**2013 £m**	2012 Restated £m
Defined benefit schemes						
Service cost						
– current service cost	**92**	80	**1**	2	**93**	82
– past service cost	**5**	13	**(5)**	–	**–**	13
– settlements	**–**	2	**–**	–	**–**	2
Net interest on the net defined benefit liability						
– interest on scheme liabilities	**253**	271	**7**	8	**260**	279
– interest on scheme assets	**(227)**	(249)	**(1)**	(1)	**(228)**	(250)
– interest on unrecognised funded scheme surpluses	**1**	6	**–**	–	**1**	6
	124	123	**2**	9	**126**	132
Defined contribution schemes	**36**	39	**–**	–	**36**	39
Total amount recognised in the income statement (note 3(a))	**160**	162	**2**	9	**162**	171

The above charges are recognised within employee benefit costs in note 3(a) and include a charge of £7 million in 2013 (2012: £14 million charge) in respect of settlements, past service costs and defined contribution costs reported as part of the restructuring costs charged in arriving at profit from operations (see note 3(e)).

The amounts recognised in other comprehensive income in respect of actuarial gains and losses of subsidiaries are as follows:

	Pension schemes		Healthcare schemes		Total	
	2013 £m	2012 Restated £m	**2013 £m**	2012 £m	**2013 £m**	2012 Restated £m
Actuarial gains/(losses) on scheme liabilities	**139**	(668)	**42**	(7)	**181**	(675)
Actuarial gains on scheme assets	**127**	294	**–**	–	**127**	294
Net actuarial gains/(losses) in other comprehensive income (note 20)	**266**	(374)	**42**	(7)	**308**	(381)

The amounts recognised in other comprehensive income in respect of surplus restrictions and minimum funding obligations of subsidiaries are as follows:

	Pension schemes		Healthcare schemes		Total	
	2013 £m	2012 Restated £m	**2013 £m**	2012 £m	**2013 £m**	2012 Restated £m
Movements in the year (note 20)	**(5)**	60	**–**	–	**(5)**	60

Notes on the accounts
continued

12 Retirement benefit schemes continued

The movements in scheme liabilities are as follows:

	Pension schemes		Healthcare schemes		Total	
	2013 £m	2012 £m	**2013 £m**	2012 £m	**2013 £m**	2012 £m
Present value at 1 January	**6,420**	5,849	**175**	172	**6,595**	6,021
Differences on exchange	**(106)**	(120)	**(15)**	(5)	**(121)**	(125)
Current service cost	**91**	81	**1**	1	**92**	82
Past service costs	**5**	13	**(5)**	–	**–**	13
Settlements	**(46)**	(3)	**–**	–	**(46)**	(3)
Interest on scheme liabilities	**244**	268	**7**	8	**251**	276
Contributions by scheme members	**2**	3	**–**	–	**2**	3
Benefits paid	**(327)**	(339)	**(7)**	(8)	**(334)**	(347)
Actuarial (gains)/losses	**(139)**	668	**(42)**	7	**(181)**	675
Present value at 31 December	**6,144**	6,420	**114**	175	**6,258**	6,595

Scheme liabilities by funding status:

Funded schemes	**5,905**	6,196	**16**	21	**5,921**	6,217
Unfunded schemes	**239**	224	**98**	154	**337**	378
Present value at 31 December	**6,144**	6,420	**114**	175	**6,258**	6,595

Scheme liabilities by scheme membership:

Active members	**1,279**	1,372	**20**	42	**1,299**	1,414
Deferred members	**912**	906	**11**	18	**923**	924
Retired members	**3,953**	4,142	**83**	115	**4,036**	4,257
Present value at 31 December	**6,144**	6,420	**114**	175	**6,258**	6,595

Approximately 95% of scheme liabilities in both years relate to guaranteed benefits.

Actuarial (gains)/losses shown above can be analysed as follows:

	Pension schemes		Healthcare schemes		Total	
	2013 £m	2012 £m	**2013 £m**	2012 £m	**2013 £m**	2012 £m
Actuarial (gains)/losses:						
– arising from changes in demographic assumptions	**26**	48	**(1)**	2	**25**	50
– arising from changes in financial assumptions	**(143)**	602	**(40)**	–	**(183)**	602
Experience (gains)/losses	**(22)**	18	**(1)**	5	**(23)**	23
Total	**(139)**	668	**(42)**	7	**(181)**	675

Changes in financial assumptions principally relate to discount rate and inflation rate movements.

12 Retirement benefit schemes continued

The movements in funded scheme assets are as follows:

	Pension schemes		Healthcare schemes		Total	
	2013 £m	2012 Restated £m	**2013 £m**	2012 £m	**2013 £m**	2012 Restated £m
Fair value of scheme assets at 1 January	**5,547**	5,184	**16**	16	**5,563**	5,200
Differences on exchange	**(93)**	(121)	**(3)**	–	**(96)**	(121)
Settlements	**(46)**	(4)	**–**	–	**(46)**	(4)
Interest on scheme assets	**219**	245	**1**	1	**220**	246
Company contributions net of reimbursements	**320**	270	**–**	6	**320**	276
Contributions by scheme members	**4**	5	**–**	–	**4**	5
Benefits paid	**(311)**	(326)	**(1)**	(7)	**(312)**	(333)
Actuarial gains	**127**	294	**–**	–	**127**	294
Fair value of scheme assets at 31 December	**5,767**	5,547	**13**	16	**5,780**	5,563

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 to pension schemes in 2014 are expected to be £265 million compared to £320 million in 2013. Company contributions for 2013 in the table above are shown net of a reimbursement of £7 million from a Jamaican pension scheme in the course of being wound up (2012: £26 million) and include £190 million in both years in respect of additional contributions to eliminate a funding shortfall relating to the main UK pension scheme.

Fair value of scheme assets by category:

	Pension schemes		Healthcare schemes		Total	
	2013 £m	2012 £m	**2013 £m**	2012 £m	**2013 £m**	2012 £m
Equities – listed	**1,908**	2,224	**5**	9	**1,913**	2,233
Equities – unlisted	**513**	196	**–**	–	**513**	196
Bonds – listed	**2,647**	2,651	**8**	5	**2,655**	2,656
Bonds – unlisted	**151**	95	**–**	–	**151**	95
Other assets – listed	**137**	21	**–**	–	**137**	21
Other assets – unlisted	**411**	360	**–**	2	**411**	362
Fair value of scheme assets at 31 December	**5,767**	5,547	**13**	16	**5,780**	5,563

Scheme assets have been diversified into equities, bonds and other assets and are typically invested via fund investment managers into both pooled and segregated mandates of listed and unlisted equities and bonds. In addition certain scheme assets, including a portion of the assets held in the main UK pension scheme, are further diversified by investing in equities listed on foreign stock exchanges via investment funds. In the above analysis investments via equity-based investment funds are shown under listed equities, and investments via bond-based investment funds shown under listed bonds. Other assets include cash and other deposits, recoverable taxes, reinsurance contracts, investment property, investments and derivatives.

In Jamaica, a pension scheme holds shares in Carreras Group Ltd (a Group subsidiary) with a fair value of £1 million (2012: £3 million). The shares are listed on the Jamaica stock exchange.

The actuarial gains and losses in both years principally relate to movements in the fair values of scheme assets and actual returns are stated net of applicable taxes and fund management fees.

	Pension schemes		Healthcare schemes		Total	
	2013 £m	2012 £m	**2013 £m**	2012 £m	**2013 £m**	2012 £m
Actual return on scheme assets	**346**	539	**1**	1	**347**	540

Notes on the accounts
continued

12 Retirement benefit schemes continued

The movements in the unrecognised scheme surpluses, recognised in other comprehensive income, are as follows:

	Pension schemes		Healthcare schemes		Total	
	2013 £m	2012 Restated £m	**2013 £m**	2012 £m	**2013 £m**	2012 Restated £m
Unrecognised funded scheme surpluses at 1 January	**(15)**	(77)	**–**	–	**(15)**	(77)
Differences on exchange	**2**	8	**–**	–	**2**	8
Interest on unrecognised funded scheme surpluses	**(1)**	(6)	**–**	–	**(1)**	(6)
Movement in year (note 20)	**(5)**	60	**–**	–	**(5)**	60
Unrecognised funded scheme surpluses at 31 December	**(19)**	(15)	**–**	–	**(19)**	(15)

Prior year movements include immaterial amounts in relation to minimum funding obligations.

The principal actuarial assumptions (weighted to reflect individual scheme differences) used in the following principal countries are shown below. In both years, discount rates are determined by reference to normal yields on high quality corporate bonds at the balance sheet date. For countries where there is not a deep market in such corporate bonds, the yield on government bonds is used.

	UK %	**Germany %**	**Canada %**	**Netherlands %**	**Switzerland %**
31 December 2013					
Rate of increase in salaries	**4.9**	**2.5**	**3.3**	**2.7**	**1.5**
Rate of increase in pensions in payment	**3.4**	**1.8**	**Nil**	**1.5**	**Nil**
Rate of increase in deferred pensions	**2.9**	**Nil**	**Nil**	**1.5**	**–**
Discount rate	**4.4**	**3.4**	**4.6**	**3.7**	**2.3**
General inflation	**3.4**	**1.8**	**2.3**	**1.5**	**Nil**

	UK years	**Germany years**	**Canada years**	**Netherlands years**	**Switzerland years**
31 December 2013					
Weighted average duration of liabilities	**16.6**	**11.2**	**11.1**	**16.0**	**15.6**

For healthcare inflation in Canada, the assumption is 4.35% increasing to 5.0% by 2018. For the remaining pension schemes, typical assumptions are that real salary increases will be from 0.5% to 3.1% per annum and discount rates will be from 0.5% to 6.8% above inflation. Pension increases, where allowed for, are generally assumed to be in line with inflation.

	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

	UK years	Germany years	Canada years	Netherlands years	Switzerland years
31 December 2012					
Weighted average duration of liabilities	16.3	11.2	12.1	15.9	15.3

For healthcare inflation in Canada, the assumption was 8.0% decreasing to 5.0% by 2018. For the remaining pension schemes, typical assumptions were that real salary increases would be from 0.5% to 3.6% per annum and discount rates would be from 0% to 4.1% above inflation. Pension increases, where allowed for, were generally assumed to be in line with inflation.

12 Retirement benefit schemes continued

Mortality assumptions are subject to regular review. The principal schemes used the following tables for both years:

UK	S1NA (year of birth) table with the Continuous Mortality Investigation (2009) model with a 1.5% long-term improvement rate.
Germany	Heubeck tables 2005G
Canada	UP94 tables
Netherlands	AG Prognosetafel 2012–2062 tables
Switzerland	LPP 2010 tables

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 2013										
Member age 65 (current life expectancy)	**22.8**	**25.0**	**18.8**	**22.8**	**19.8**	**22.1**	**20.4**	**24.8**	**21.3**	**23.8**
Member age 45 (life expectancy at age 65)	**25.1**	**27.4**	**21.4**	**25.4**	**21.3**	**22.9**	**22.4**	**25.7**	**23.1**	**25.5**
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

Valuation of retirement benefit schemes involves judgements about uncertain future events. Sensitivities in respect of the key assumptions used to measure the principal pension schemes as at 31 December 2013 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	**160**	**(149)**		
Rate of inflation – increase/(decrease) of scheme liabilities			**168**	**(148)**
Discount rate – (decrease)/increase of scheme liabilities			**(175)**	**199**

A one percentage point increase in healthcare inflation would increase healthcare scheme liabilities by £14 million, and a one percentage point decrease would decrease liabilities by £11 million. The income statement effect of this change in assumption is not material.

Notes on the accounts
continued

13 Deferred tax

Deferred tax assets comprise:

	Stock relief £m	Excess of depreciation over capital allowances £m	Tax losses £m	Retirement benefits Restated £m	Fair value losses/(gains) £m	Other temporary differences £m	Total Restated £m
At 1 January 2013	**65**	**37**	**36**	**170**	**4**	**191**	**503**
Differences on exchange	**(7)**	**(1)**	**(5)**	**(5)**	**–**	**(15)**	**(33)**
(Charged)/credited to the income statement	**(12)**	**(2)**	**36**	**(2)**	**(1)**	**(19)**	**–**
Charged to other comprehensive income	**–**	**–**	**–**	**(59)**	**(3)**	**–**	**(62)**
At 31 December 2013	**46**	**34**	**67**	**104**	**–**	**157**	**408**
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	(13)	9	(45)	18
Credited/(charged) to other comprehensive income	–	–	–	59	(10)	(5)	44
At 31 December 2012	65	37	36	170	4	191	503

Deferred tax liabilities comprise:

	Stock relief £m	Excess of capital allowances over depreciation £m	Undistributed earnings of associates and subsidiaries £m	Retirement benefits Restated £m	Fair value (losses)/gains £m	Other temporary differences £m	Total Restated £m
At 1 January 2013	**16**	**182**	**168**	**119**	**24**	**167**	**676**
Differences on exchange	**1**	**(13)**	**(13)**	**2**	**–**	**(3)**	**(26)**
(Credited)/charged to the income statement	**(6)**	**(5)**	**26**	**5**	**1**	**12**	**33**
(Credited)/charged to other comprehensive income	**–**	**–**	**–**	**(21)**	**12**	**–**	**(9)**
At 31 December 2013	**11**	**164**	**181**	**105**	**37**	**176**	**674**
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	(18)	(4)
Charged to other comprehensive income	–	–	–	5	19	–	24
At 31 December 2012	16	182	168	119	24	167	676

	2013 £m	2012 £m
Net deferred tax liabilities	**266**	173

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.

	2013 £m	2012 £m
Deferred tax assets	**(248)**	(327)
Deferred tax liabilities	**514**	500
	266	173

Deferred tax expected to be recovered within 12 months:

	2013 £m	2012 £m
Deferred tax assets	**(115)**	(117)
Deferred tax liabilities	**300**	169
	185	52

At the balance sheet date, the Group has unused tax losses of £598 million (2012: £289 million) which have no expiry date and unused tax losses of £558 million (2012: £632 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 £1,005 million (2012: £1,221 million), which have no expiry date and £159 million (2012: £177 million), which will expire within the next 10 years.

At the balance sheet date, the Group has unused tax credits of £80 million (2012: £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 (2012: £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

	2013 £m	2012 £m
Trade receivables	**2,208**	2,088
Loans and other receivables	**692**	712
Prepayments and accrued income	**147**	165
	3,047	2,965
Current	**2,876**	2,741
Non-current	**171**	224
	3,047	2,965

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:

	2013 £m	2012 £m
Gross trade and other receivables	**3,103**	3,017
Allowance account	**(56)**	(52)
Net trade and other receivables per balance sheet	**3,047**	2,965

Notes on the accounts
continued

14 Trade and other receivables continued

The movements in the allowance account are as follows:

	2013 £m	2012 £m
1 January	**52**	49
Differences on exchange	**(3)**	(3)
Provided in the year	**10**	14
Amounts reversed during the year	**(3)**	(8)
31 December	**56**	52

Impairment of trade receivables, including write-offs and allowances, charged during the year is included as part of other operating expenses. For 2013, the net impairment charged was £9 million (2012: £9 million) of which £7 million (2012: £6 million), is reflected in the above table.

As at 31 December 2013, trade and other receivables of £46 million (2012: £41 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:

	2013 £m	2012 £m
Less than three months	**34**	36
Between three and six months	**4**	2
Between six months and one year	**3**	1
Greater than one year	**5**	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:

	2013 £m	2012 £m
US dollar	**107**	76
UK sterling	**131**	136
Euro	**31**	33
Other currencies	**172**	62

Trade and other receivables also include certain interest bearing amounts and their effective interest rates are as follows:

	2013 £m	2012 £m	**2013 %**	2012 %
UK sterling	**5**	–	**10.0**	–
Euro	**5**	5	**4.0**	4.0
Other currencies	**3**	12	**5.1**	5.9

There is no material difference between the above amounts for trade and other receivables and their fair value due to the short-term duration of the majority of trade and other receivables as determined using discounted cash flow analysis. There is no concentration of credit risk with respect to trade receivables as the Group has a large number of internationally dispersed customers.

15 Available-for-sale investments

	2013 £m	2012 £m
1 January	**63**	97
Differences on exchange	**1**	(4)
Additions and advances	**46**	1
Disposals and repayments	**(20)**	(31)
31 December	**90**	63
Current	**54**	26
Non-current	**36**	37
	90	63

The classification of these investments under the IFRS 13 fair value hierarchy is given in note 24.

Investments have the following maturities:

	As per balance sheet	
	2013 £m	2012 £m
Equity investments	**36**	37
Non-equity investments		
– within one year	**53**	24
– beyond three years and within four years	**1**	–
– beyond four years and within five years	**–**	2
	90	63

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:

	2013 £m	2012 £m
Functional currencies	**90**	62
US dollar	**–**	1
	90	63

Non-equity investments of £54 million (2012: £26 million) are principally denominated in UK sterling and have an effective interest rate of 5.5% (2012: 1.1%).

Notes on the accounts
continued

16 Derivative financial instruments

The fair values of derivatives are determined based on market data (primarily yield curves, implied volatilities and exchange rates) to calculate the present value of all estimated flows associated with each derivative at the balance sheet date. In the absence of sufficient market data, fair values would be based on the quoted market price of similar derivatives. The classification of these derivative assets and liabilities under the IFRS 13 fair value hierarchy is given in note 24.

	2013		2012	
	Assets £m	**Liabilities £m**	Assets £m	Liabilities £m
Fair value hedges				
– interest rate swaps	**121**	**63**	209	55
– cross-currency swaps	**6**	**38**	10	12
Cash flow hedges				
– cross-currency swaps	**–**	**3**	–	18
– forward foreign currency contracts	**106**	**25**	70	31
Net investment hedges				
– forward foreign currency contracts	**161**	**5**	59	12
Held-for-trading*				
– forward foreign currency contracts	**31**	**30**	25	22
– others	**–**	**–**	–	1
Total	**425**	**164**	373	151
Current	**312**	**34**	166	65
Non-current	**113**	**130**	207	86
	425	**164**	373	151
Derivatives				
– in respect of net debt	**146**	**125**	234	95
– other	**279**	**39**	139	56
	425	**164**	373	151

* As explained in note 4, some derivative financial instruments are not designated as hedges and so are required to be classified as held-for-trading.

For cash flow hedges the timing of expected cash flows is as follows:

	2013		2012	
	Assets £m	**Liabilities £m**	Assets £m	Liabilities £m
Within one year	**92**	**27**	49	31
Between one and two years	**14**	**1**	21	18
	106	**28**	70	49

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.

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:

	2013				2012			
	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	**5,681**	**(5,405)**	**2,949**	**(3,006)**	5,997	(5,873)	2,881	(2,956)
– cross-currency swaps	**4**	**(2)**	**195**	**(182)**	18	(11)	47	(43)
Between one and two years								
– forward foreign currency contracts	**276**	**(260)**	**63**	**(64)**	503	(479)	115	(116)
– cross-currency swaps	**4**	**(2)**	**33**	**(16)**	18	(11)	158	(163)
Between two and three years								
– cross-currency swaps	**4**	**(3)**	**358**	**(415)**	18	(13)	18	(6)
Between three and four years								
– cross-currency swaps	**4**	**(4)**	**15**	**(19)**	18	(14)	343	(389)
Between four and five years								
– cross-currency swaps	**4**	**(4)**	**15**	**(21)**	18	(16)	–	–
Beyond five years								
– cross-currency swaps	**110**	**(100)**	**461**	**(513)**	575	(616)	–	–
	6,087	**(5,780)**	**4,089**	**(4,236)**	7,165	(7,033)	3,562	(3,673)

The maturity dates of net-settled derivative financial instruments are as follows:

	2013		2012	
	Assets Inflow/ (Outflow) £m	**Liabilities (Inflow)/ Outflow £m**	Assets Inflow/ (Outflow) £m	Liabilities (Inflow)/ Outflow £m
Within one year	**50**	**(22)**	64	12
Between one and two years	**27**	**(14)**	63	11
Between two and three years	**10**	**1**	31	6
Between three and four years	**9**	**11**	24	15
Between four and five years	**9**	**12**	20	12
Beyond five years	**23**	**89**	14	–
	128	**77**	216	56

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:

	2013		2012	
	Assets £m	**Liabilities £m**	Assets £m	Liabilities £m
Interest rate swaps	**121**	**63**	209	55
Cross-currency swaps	**6**	**41**	10	30
Forward foreign currency contracts	**298**	**60**	154	65
Others	**–**	**–**	–	1
	425	**164**	373	151

Notes on the accounts
continued

16 Derivative financial instruments continued

(a) Interest rate swaps

								2013
					Interest rate %			
	Maturity date	Principal currency	m	£m	Original	Swapped	Assets £m	Liabilities £m
Fixed to floating	**2014**	**GBP**	**500**	**500**	**6.0**	**note (a)**	**13**	**–**
	2014	**GBP**	**250**	**250**	**6.0**	**note (a)**	**11**	**–**
	2017	**USD**	**600**	**362**	**2.1**	**note (a)**	**–**	**1**
	2019	**GBP**	**250**	**250**	**6.4**	**note (a)**	**43**	**–**
	2020	**EUR**	**600**	**499**	**4.0**	**note (a)**	**47**	**–**
	2020	**GBP**	**650**	**650**	**4.0**	**note (a)**	**–**	**8**
	2023	**EUR**	**750**	**624**	**2.4**	**note (a)**	**–**	**4**
	2025	**EUR**	**650**	**541**	**2.8**	**note (a)**	**–**	**15**
Floating to fixed	**2017**	**EUR**	**600**	**499**	**note (a)**	**3.7**	**–**	**35**
	2023*	**EUR**	**750**	**624**	**note (a)**	**2.8**	**7**	**–**
							121	**63**

* The €750 million euro interest rate swap maturing in 2023 has a start date of 2015.

								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

Note (a): the floating rate interest rates are based on LIBOR (or local equivalent) plus a margin ranging between 67 and 268 basis points (2012: between 67 and 268 basis points).

These swaps have been used to manage the interest rate profile of external borrowings and are reflected in the repricing table in note 21.

16 Derivative financial instruments continued

(b) Cross-currency swaps

2013

	Maturity date	Original currency	Interest rate %	Principal original currency m	£m	Swapped currency	Interest rate %	Principal swapped currency m	£m	Assets £m	Liabilities £m
Fixed to floating	**2016**	**GBP**	**5.5**	**325**	**325**	**EUR**	**note (b)**	**473**	**394**	**–**	**37**
	2019	**EUR**	**4.6**	**20**	**17**	**USD**	**note (b)**	**22**	**12**	**6**	**–**
	2021	**EUR**	**3.6**	**600**	**499**	**GBP**	**note (b)**	**518**	**518**	**–**	**1**
Floating to fixed	**2014**	**USD**	**note (b)**	**261**	**158**	**COP**	**7.2**	**504,158**	**158**	**–**	**3**
										6	**41**

2012

	Maturity date	Original currency	Interest rate %	Principal original currency m	£m	Swapped currency	Interest rate %	Principal swapped currency m	£m	Assets £m	Liabilities £m
Fixed to floating	2016	GBP	5.5	325	325	EUR	note (b)	473	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

Note (b): the floating rate interest rates are based on LIBOR (or local equivalent) plus a margin ranging between 82 and 250 basis points (2012: 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.

	2013		2012	
	Assets £m	**Liabilities £m**	Assets £m	Liabilities £m
Purchase/Sell				
GBP/EUR	**17**	**1**	12	5
GBP/AUD	**70**	**–**	9	2
GBP/ZAR	**19**	**–**	2	–
GBP/CHF	**5**	**1**	10	–
GBP/USD	**56**	**–**	28	–
GBP/CAD	**16**	**–**	2	–
EUR/USD	**5**	**–**	7	–
USD/EUR	**–**	**13**	2	16
USD/GBP	**–**	**14**	–	4
USD/JPY	**82**	**–**	56	–
Other	**28**	**31**	26	38
	298	**60**	154	65

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:

	2013		2012	
	Purchase £m	**Sell £m**	Purchase £m	Sell £m
Purchase/Sell				
GBP/CHF	**(226)**	**225**	(221)	221
GBP/CAD	**(211)**	**207**	(292)	287
GBP/USD	**(187)**	**181**	–	–
GBP/EUR	**(125)**	**124**	(362)	362
EUR/DKK	**(313)**	**313**	(344)	344
EUR/SEK	**(129)**	**131**	(131)	131
EUR/NOK	**(150)**	**149**	(166)	166

17 Inventories

	2013 £m	2012 £m
Raw materials and consumables	**1,700**	1,725
Finished goods and work in progress	**2,144**	2,079
Goods purchased for resale	**198**	222
	4,042	4,026

Inventories pledged as security for liabilities amount to £14 million (2012: £8 million). Write-offs taken to other operating expenses in the Group income statement comprise £45 million (2012: £57 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 2013 and 2012.

19 Cash and cash equivalents

	2013 £m	2012 £m
Cash and bank balances	**1,399**	977
Cash equivalents	**707**	1,104
	2,106	2,081

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:

	2013 £m	2012 £m
Functional currency	**1,804**	1,383
US dollar	**104**	532
UK sterling	**57**	5
Euro	**54**	63
Other currencies	**87**	98
	2,106	2,081

At 31 December 2013, cash and cash equivalents of £3 million (2012: £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:

	2013 £m	2012 £m
Cash and cash equivalents as above	**2,106**	2,081
Less accrued interest	**(1)**	–
Less overdrafts	**(329)**	(242)
Net cash and cash equivalents	**1,776**	1,839

Cash and cash equivalents include restricted amounts of £158 million (2012: £151 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 2013	**507**	**3,916**	**796**	**2,253**	**7,472**	**307**	**7,779**
Comprehensive income and expense							
Profit for the year	–	–	–	3,904	3,904	295	4,199
Differences on exchange							
– subsidiaries	–	–	(935)	–	(935)	(37)	(972)
– associates	–	–	(141)	–	(141)	–	(141)
Cash flow hedges							
– net fair value gains	–	–	103	–	103	(9)	94
– reclassified and reported in profit for the year	–	–	(56)	–	(56)	7	(49)
– reclassified and reported in net assets	–	–	(1)	–	(1)	–	(1)
Available-for-sale investments							
– net fair value losses	–	–	(7)	–	(7)	–	(7)
Net investment hedges							
– net fair value gains	–	–	89	–	89	–	89
– differences on exchange on borrowings	–	–	(25)	–	(25)	–	(25)
Tax on items recognised directly in other comprehensive income that may be reclassified subsequently to profit or loss (note 6(d))	–	–	(13)	–	(13)	–	(13)
Retirement benefit schemes							
– actuarial gains in respect of subsidiaries (note 12)	–	–	–	309	309	(1)	308
– surplus recognition and minimum funding obligations in respect of subsidiaries (note 12)	–	–	–	(6)	(6)	1	(5)
– actuarial gains in respect of associates net of tax (note 5)	–	–	–	90	90	–	90
Tax on items recognised directly in other comprehensive income that will not be reclassified subsequently to profit or loss (note 6(d))	–	–	–	(39)	(39)	1	(38)
Other changes in equity							
Employee share options							
– value of employee services	–	–	–	61	61	–	61
– proceeds from shares issued	–	3	–	1	4	–	4
Dividends and other appropriations							
– ordinary shares	–	–	–	(2,611)	(2,611)	–	(2,611)
– to non-controlling interests	–	–	–	–	–	(271)	(271)
Purchase of own shares							
– held in employee share ownership trusts	–	–	–	(74)	(74)	–	(74)
– share buy-back programme	–	–	–	(1,509)	(1,509)	–	(1,509)
Non-controlling interests – capital injection (note 26)	–	–	–	–	–	8	8
Other movements	–	–	–	19	19	–	19
31 December 2013	**507**	**3,919**	**(190)**	**2,398**	**6,634**	**301**	**6,935**

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 Restated £m	Total attributable to owners of the parent Restated £m	Non-controlling interests Restated £m	Total equity Restated £m
1 January 2012	506	3,913	1,112	2,636	8,167	307	8,474
Comprehensive income and expense							
Profit for the year	–	–	–	3,797	3,797	279	4,076
Differences on exchange							
– subsidiaries	–	–	(355)	–	(355)	(24)	(379)
– associates	–	–	(145)	–	(145)	–	(145)
Cash flow hedges							
– net fair value losses	–	–	(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
Tax on items recognised directly in other comprehensive income that may be reclassified subsequently to profit or loss (note 6(d))	–	–	(36)	–	(36)	–	(36)
Retirement benefit schemes							
– actuarial losses in respect of subsidiaries (note 12)	–	–	–	(378)	(378)	(3)	(381)
– surplus recognition and minimum funding obligations in respect of subsidiaries (note 12)	–	–	–	41	41	19	60
– actuarial losses in respect of associates net of tax (note 5)	–	–	–	(39)	(39)	–	(39)
Tax on items recognised directly in other comprehensive income that will not be reclassified subsequently to profit or loss (note 6(d))	–	–	–	58	58	(4)	54
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

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

(a) Share premium account, capital redemption reserves and merger reserves comprise:

	Share premium account £m	Capital redemption reserves £m	Merger reserves £m	Total £m
1 January 2012	64	101	3,748	3,913
31 December 2012	67	101	3,748	3,916
31 December 2013	**70**	**101**	**3,748**	**3,919**

The share premium account includes the difference between the value of shares issued and their nominal value. The increase of £3 million (2012: £3 million) relates solely to ordinary shares issued under the Company's share option schemes. These schemes are described in the Remuneration Report.

On the purchase of own shares as part of the share buy-back programme for shares which are cancelled, a transfer is made from retained earnings to the capital redemption reserve equivalent to the nominal value of shares purchased. Purchased shares which are not cancelled are classified as treasury shares and presented as a deduction from total equity.

Total equity attributable to owners of the parent is stated after deducting the cost of treasury shares which include £4,045 million (2012: £2,536 million) for shares repurchased and not cancelled and £280 million (2012: £288 million) in respect of the cost of own shares held in employee share ownership trusts.

During 2013, 44 million shares were bought back at a cost of £1,500 million (2012: 39 million shares at a cost of £1,250 million) excluding transaction costs of £9 million (2012: £8 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.

(b) Information on the principal components of non-controlling interests is provided in note 31.

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:

							Retained earnings	
	Translation reserve £m	Hedging reserve £m	Available-for-sale reserve £m	Revaluation reserve £m	Other £m	Total other reserves £m	Treasury shares £m	Other £m
1 January 2013	**(3)**	**11**	**36**	**179**	**573**	**796**	**(2,824)**	**5,077**
Comprehensive income and expense								
Profit for the year	–	–	–	–	–	–	–	3,904
Differences on exchange								
– subsidiaries	(935)	–	–	–	–	(935)	–	–
– associates	(141)	–	–	–	–	(141)	–	–
Cash flow hedges								
– net fair value gains	–	103	–	–	–	103	–	–
– reclassified and reported in profit for the year	–	(56)	–	–	–	(56)	–	–
– reclassified and reported in net assets	–	(1)	–	–	–	(1)	–	–
Available-for-sale investments								
– net fair value losses	–	–	(7)	–	–	(7)	–	–
Net investment hedges								
– net fair value gains	89	–	–	–	–	89	–	–
– differences on exchange on borrowings	(25)	–	–	–	–	(25)	–	–
Tax on items recognised directly in other comprehensive income that may be reclassified subsequently to profit or loss	–	(13)	–	–	–	(13)	–	–
Retirement benefit schemes								
– actuarial gains in respect of subsidiaries (note 12)	–	–	–	–	–	–	–	309
– surplus recognition and minimum funding obligations in respect of subsidiaries (note 12)	–	–	–	–	–	–	–	(6)
– actuarial gains in respect of associates net of tax (note 5)	–	–	–	–	–	–	–	90
Tax on items recognised directly in other comprehensive income that will not be reclassified subsequently to profit or loss	–	–	–	–	–	–	–	(39)
Other changes in equity								
Employee share options								
– value of employee services	–	–	–	–	–	–	–	61
– proceeds from shares issued	–	–	–	–	–	–	1	–
Dividends and other appropriations								
– ordinary shares	–	–	–	–	–	–	–	(2,611)
Purchase of own shares								
– held in employee share ownership trusts	–	–	–	–	–	–	(74)	–
– share buy-back programme	–	–	–	–	–	–	(1,509)	–
Other movements	–	–	–	–	–	–	81	(62)
31 December 2013	**(1,015)**	**44**	**29**	**179**	**573**	**(190)**	**(4,325)**	**6,723**

Notes on the accounts
continued

20 Capital and reserves – reconciliation of movement in total equity continued

							Retained earnings	
	Translation reserve £m	Hedging reserve £m	Available-for-sale reserve £m	Revaluation reserve £m	Other £m	Total other reserves £m	Treasury shares £m	Other Restated £m
1 January 2012	349	(29)	40	179	573	1,112	(1,539)	4,175
Comprehensive income and expense								
Profit for the year	–	–	–	–	–	–	–	3,797
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	–	–
Tax on items recognised directly in other comprehensive income that may be reclassified subsequently to profit or loss	(7)	(29)	–	–	–	(36)	–	–
Retirement benefit schemes								
– actuarial losses in respect of subsidiaries (note 12)	–	–	–	–	–	–	–	(378)
– surplus recognition and minimum funding obligations in respect of subsidiaries (note 12)	–	–	–	–	–	–	–	41
– actuarial losses in respect of associates net of tax (note 5)	–	–	–	–	–	–	–	(39)
Tax on items recognised directly in other comprehensive income that will not be reclassified subsequently to profit or loss	–	–	–	–	–	–	–	58
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

The translation reserve is as explained in the accounting policy on foreign currencies in note 1.

The hedging reserve and the available-for-sale reserve are as explained in the accounting policy on financial instruments in note 1.

The revaluation reserve relates to the acquisition of the cigarette and snus business of ST in 2008.

Of the amounts released from the hedging reserve during the year, gains of £28 million (2012: £5 million loss) and gains of £11 million (2012: £26 million loss) were reported within revenue and raw materials and consumables respectively, together with a loss of £3 million (2012: £5 million loss) reported in other operating expenses and a gain of £13 million (2012: £35 million loss) 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:

	2013 £m	2012 Restated £m
Translation reserve		
Differences on exchange	–	(2)
Net investment hedges		
– difference on exchange on borrowings	–	(5)
	–	(7)
Hedging reserve		
Cash flow hedges		
– net fair value gains	**(36)**	(17)
– reclassified and reported in profit for the year	**23**	(12)
	(13)	(29)
Retained earnings		
– actuarial (gains)/losses in respect of subsidiaries	**(41)**	66
– surplus recognition and minimum funding obligations in respect of subsidiaries	**2**	(8)
	(39)	58
Owners of the parent	**(52)**	22
Non-controlling interests	**1**	(4)
Total tax recognised in other comprehensive income for the year (note 6(d))	**(51)**	18

Notes on the accounts
continued

21 Borrowings

	Currency	Maturity dates	Interest rates	2013 £m	2012 £m
Eurobonds	Euro	2014 to 2023	2.4% to 5.9%	**5,372**	5,208
	UK sterling	2016 to 2040	4.0% to 7.3%	**3,118**	2,670
	US dollar	2016	1.0% to 1.2%	**182**	–
Bonds issued pursuant to Rule 144A and RegS under the US Securities Act (as amended)	US dollar	2014 to 2022	1.4% to 9.5%	**1,620**	1,840
Other notes	Malaysian ringgit	2014	4.1% to 4.5%	**47**	51
	Other currencies			**24**	25
Commercial paper				**521**	–
Bank loans				**341**	543
Other loans				**136**	135
Finance leases				**6**	5
Overdrafts				**329**	242
				11,696	10,719

The interest on the commercial paper referred to in the table above is based on USD LIBOR plus a margin ranging between 10 and 15 basis points (2012: nil).

	2013 £m	2012 £m
Current	**1,980**	1,636
Non-current	**9,716**	9,083
	11,696	10,719

Current borrowings include interest payable of £247 million at 31 December 2013 (2012: £222 million). Included within borrowings are £4,466 million (2012: £3,731 million) of borrowings subject to fair value hedges where their amortised cost has been increased by £69 million (2012: £220 million) in the table above.

The fair value of borrowings is estimated to be £12,701 million (2012: £12,041 million). £11,873 million (2012: £11,116 million) has been calculated using quoted market prices and is within level 1 of the fair value hierarchy. £828 million (2012: £925 million) has been calculated based on discounted cash flow analysis and is within level 2 of the fair value hierarchy.

	2013 £m	2012 £m
Amounts secured on Group assets	**20**	13

In both years amounts secured on Group assets include finance leases of £6 million (2012: £5 million) and amounts secured on certain inventory of the Group (see note 17).

Borrowings are repayable as follows:

	Per Balance Sheet		Contractual gross maturities	
	2013 £m	2012 £m	2013 £m	2012 £m
Within one year	**1,980**	1,636	**2,220**	1,783
Between one and two years	**1,343**	666	**1,798**	1,099
Between two and three years	**534**	1,319	**899**	1,730
Between three and four years	**1,513**	369	**1,790**	672
Between four and five years	**421**	1,508	**853**	1,862
Beyond five years	**5,905**	5,221	**7,732**	6,874
	11,696	10,719	**15,292**	14,020

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	Other currencies £m	Total £m
31 December 2013							
Total borrowings	**5,643**	**2,353**	**329**	**3,248**	**–**	**123**	**11,696**
Effect of derivative financial instruments							
– cross-currency swaps	**1,070**	**(146)**	**(325)**	**(516)**	**–**	**–**	**83**
– forward foreign currency contracts	**(749)**	**181**	**–**	**(468)**	**207**	**818**	**(11)**
	5,964	**2,388**	**4**	**2,264**	**207**	**941**	**11,768**
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

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 2013							
Total borrowings	**2,013**	**1,341**	**655**	**1,392**	**420**	**5,875**	**11,696**
Effect of derivative financial instruments							
– interest rate swaps	**2,427**	**(624)**	**–**	**137**	**–**	**(1,940)**	**–**
– cross-currency swaps	**924**	**–**	**(325)**	**–**	**–**	**(516)**	**83**
	5,364	**717**	**330**	**1,529**	**420**	**3,419**	**11,779**
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

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:

	2013 **Total** **£m**	2012 Total £m
Within one year	**2**	2
Between one and two years	**2**	2
Between two and three years	**1**	1
Between three and four years	**1**	–
	6	5

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:

	2013 **£m**	2012 £m
Within one year	**169**	131
Between one and two years	**2,000**	–
Between two and three years	**–**	2,000
Between three and four years	**91**	–
Between four and five years	**–**	92
	2,260	2,223

The Group defines net debt as follows:

	2013 **£m**	2012 £m
Borrowings (note 21)	**11,696**	10,719
Derivatives in respect of net debt:		
– assets (note 16)	**(146)**	(234)
– liabilities (note 16)	**125**	95
Cash and cash equivalents (note 19)	**(2,106)**	(2,081)
Current available-for-sale investments (note 15)	**(54)**	(26)
	9,515	8,473

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 2013	**92**	**45**	**271**	**221**	**629**
Differences on exchange	**(4)**	**(4)**	**–**	**(26)**	**(34)**
Provided in respect of the year	**42**	**12**	**–**	**52**	**106**
Utilised during the year	**(42)**	**(11)**	**(4)**	**(63)**	**(120)**
31 December 2013	**88**	**42**	**267**	**184**	**581**
Analysed on the balance sheet as					
– current	**49**	**18**	**–**	**127**	**194**
– non-current	**39**	**24**	**267**	**57**	**387**
	88	**42**	**267**	**184**	**581**
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 2013 and 2012 are as described in note 3(e). While some elements of the non-current provisions of £39 million will unwind over several years, as termination payments are made over extended periods in some countries, it is estimated that approximately 45% will unwind in 2015 and over 89% within five years.

Employee-related benefits mainly relate to long-term employee benefits other than post-employment benefits. As the principal components of these provisions are long service awards and ‘jubilee’ payments due after a certain service period, they will unwind over several years. It is estimated that approximately 17% of the non-current provisions of £24 million will unwind within five years.

A provision 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 £10 million for restructuring of existing businesses, £1 million for employee benefits and £28 million for other provisions.

Notes on the accounts
continued

23 Trade and other payables

	2013 £m	2012 £m
Trade payables	**814**	679
Duty, excise and other taxes	**3,642**	3,736
Accrued charges and deferred income	**1,038**	1,156
Social security and other taxation	**18**	15
Sundry payables	**360**	407
	5,872	5,993
Current	**5,741**	5,827
Non-current	**131**	166
	5,872	5,993

Accrued charges and deferred income include £3 million (2012: £5 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, as determined using discounted cash flow analysis.

Trade and other payables are predominantly denominated in the functional currencies of subsidiary undertakings with less than 5% in other currencies (2012: less than 3%).

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 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 2013, the average centrally managed debt maturity was 7.2 years (2012: 7.2 years) and the highest proportion of centrally managed debt maturing in a single rolling year was 18.3% (2012: 19.3%).

In December 2013 a maturing £152 million bond was repaid, this repayment was financed from Group cash balances.

In November 2013 a maturing US$300 million bond was repaid, this repayment was financed from Group cash balances.

In September 2013 the Group issued a new £650 million bond with a maturity of 2026.

In July 2013 the Group repaid a maturing €519 million bond, this repayment was financed from Group cash balances.

In March 2013 the Group issued a new €650 million bond with a maturity of 2025 and a new US$300 million bond with a maturity of 2016.

During the year, the Group's subsidiary in Brazil received proceeds of £399 million (2012: £356 million) from short-term borrowings in respect of advance payments on leaf export contracts and repaid £436 million (2012: £350 million).

24 Financial instruments and risk management continued

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 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 2013 (31 December 2012: US$225 million). The undrawn element of US$15 million was available for drawing until February 2013.

The Group continues to have a £2 billion central banking facility with a final maturity date of December 2015. The facility is provided by 22 banks and was undrawn as at 31 December 2013 (31 December 2012: undrawn).

It is Group policy that short-term sources of funds (including drawings under both the Group US$2 billion commercial paper programme, and the Group £1 billion euro commercial paper (ECP) programme) are backed by undrawn committed lines of credit and cash.
At 31 December 2013, commercial paper of £521 million was outstanding (31 December 2012: £nil).

During 2012 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, leading to an increase of £75 million in cash generated from operations. During 2013 this arrangement was increased by £17 million.

The Group utilises cash pooling and zero balancing bank account structures in addition to intercompany 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 2013 the ratings from Moody's and S&P were A3 (stable outlook) / A- (stable outlook) (2012: Baa1/ A-). The Moody's rating was upgraded from Baa1 to A3 on 12 March 2013. The strength of the ratings has underpinned the debt issuance during 2013 and 2012 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 2013 and 2012.

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 2013, cash and cash equivalents include £156 million invested in money market funds (2012: £434 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.

Notes on the accounts
continued

24 Financial instruments and risk management continued

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 2013, the currency profile of the Group's gross debt, after taking into account derivative contracts, was 21% (2012: 17%) US dollar, 41% (2012: 45%) euro, 2% (2012: 3%) Canadian dollar, 21% (2012: 18%) sterling, and 15% (2012: 17%) other currencies.

The Group faces currency exposures arising from the translation of profits earned in foreign currency subsidiaries and associates and joint arrangements; these exposures are not normally hedged. Exposures also arise from:

(i) foreign currency denominated trading transactions undertaken by subsidiaries. These exposures comprise committed and highly probable forecast sales and purchases, which are offset wherever possible. The remaining exposures are hedged within the Treasury policies and procedures with forward foreign exchange contracts and options, which are designated as hedges of the foreign exchange risk of the identified future transactions; and

(ii) forecast dividend flows from subsidiaries to the centre. To ensure cash flow certainty, the Group 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.

A 10% strengthening of functional currencies against non-functional currencies would result in pre-tax profit being £24 million higher (2012: £1 million higher) and items recognised directly in other comprehensive income being £15 million higher (2012: £5 million lower). A 10% weakening of functional currencies against non-functional currencies would result in pre-tax profit being £31 million lower (2012: £1 million lower) and items recognised directly in other comprehensive income being £19 million lower (2012: £5 million higher).

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 2013 it is 12.3 times (2012 restated: 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 2013, the relevant ratios of floating to fixed rate borrowings were 43:57 (2012: 35:65) on a gross basis and 25:75 (2012: 16:84) 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 £22 million lower (2012: £16 million lower). A 100 basis point decrease in interest rates, or less where applicable, would result in pre-tax profit being £1 million higher (2012: £1 million higher). The effect of these interest rate changes on items recognised directly in other comprehensive income is not material in either year.

24 Financial instruments and risk management continued

Credit risk

The Group has no significant concentrations of customer credit risk. Subsidiaries have policies in place requiring appropriate credit checks on potential customers before sales commence. The process for monitoring and managing credit risk once sales to customers have been made varies depending on local practice in the countries concerned.

Certain territories have bank guarantees, other guarantees and credit insurance provided in the Group's favour in respect of Group trade receivables, the issuance and terms of which are dependent on local practices in the countries concerned.

All derivatives are subject to ISDA agreements or equivalent documentation.

Cash deposits and other financial instruments give rise to credit risk on the amounts due from the related counterparties. Generally the Group targets a long-term counterparty credit rating of at least A-/A3. However, the Group recognises that due to the need to operate over a large geographic footprint, sovereign risk can be the determining factor on the suitability of a counterparty. From time to time the Group may invest in short-dated corporate commercial paper and for this, the Group identifies specific counterparties with a minimum short-term rating of A1/P1.

Counterparty credit risk is managed on a global basis by limiting the aggregate amount and duration of exposure to any one counterparty, taking into account its credit rating. The credit ratings of all counterparties are reviewed regularly.

The Group ensures that it has sufficient counterparty credit capacity of requisite quality to undertake all anticipated transactions throughout its geographic footprint, while at the same time ensuring that there is no geographic concentration in the location of counterparties.

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 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 £30 million (2012: £26 million).

The impact of own credit risk on the fair value of derivatives and other obligations held at fair value is not material.

Price risk

The Group is exposed to equity price risk on equity investments held by the Group, which are included in available-for-sale investments on the consolidated balance sheet, but the quantum of such is not material.

Hedge accounting

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

Fair value estimation

The fair values of financial assets and liabilities with maturities of less than one year, other than derivatives, are assumed to approximate their book values. For other financial instruments which are measured at fair value in the balance sheet, the basis for fair values is described below.

Fair value hierarchy

The following table presents the Group's financial assets and liabilities that are measured at fair value in accordance with the IFRS 13 classification hierarchy:

				2013
	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Assets at fair value				
Available-for-sale investments (note 15)	54	–	36	90
Derivatives relating to				
– interest rate swaps (note 16)	–	121	–	121
– cross-currency swaps (note 16)	–	6	–	6
– forward foreign currency contracts (note 16)	–	298	–	298
Assets at fair value	54	425	36	515
Liabilities at fair value				
Derivatives relating to				
– interest rate swaps (note 16)	–	63	–	63
– cross-currency swaps (note 16)	–	41	–	41
– forward foreign currency contracts (note 16)	–	60	–	60
Liabilities at fair value	–	164	–	164

Notes on the accounts
continued

24 Financial instruments and risk management continued

	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

Level 1 financial instruments are traded in an active market and fair value is based on quoted prices at the year end.

Level 2 financial instruments are not traded in an active market, but the fair values are based on quoted market prices, broker/dealer quotations, or alternative pricing sources with reasonable levels of price transparency. The Group's level 2 financial instruments include OTC derivatives.

The fair values of level 3 financial instruments have been determined using a valuation technique where at least one input (which could have a significant effect on the instrument's valuation) is not based on observable market data. The Group's level 3 financial instruments primarily consist of an equity investment in an unquoted entity which is valued using the discounted cash flows of estimated future dividends. The valuation assumes the following:

- future dividends grow by 2.0% (2012: 2.0%) and a 100 basis points decrease in the growth rate would result in the valuation being £6 million lower (2012: £7 million lower); and
- discount rate of 6.5% (2012: 6.5%) and a 100 basis points decrease in the discount rate would result in the valuation being £10 million higher (2012: £11 million higher).

The following table presents the changes in level 3 financial instruments:

	2013	2012
	Available-for-sale investments £m	Available-for-sale investments £m
1 January	**37**	38
Differences on exchange	**(1)**	(1)
31 December	**36**	37

24 Financial instruments and risk management continued

Netting arrangements of derivative financial instruments

The gross fair value of derivative financial instruments as presented in the Group Balance Sheet, together with the Group's rights of offset associated with recognised financial assets and recognised financial liabilities subject to enforceable master netting arrangements and similar agreements, is summarised as follows:

	2013			2012		
	Amount presented in the Group Balance Sheet* £m	**Related amounts not offset in the Group Balance Sheet £m**	**Net amount £m**	Amount presented in the Group Balance Sheet* £m	Related amounts not offset in the Group Balance Sheet £m	Net amount £m
Financial assets						
– Derivative financial instruments (note 16)	**425**	**(144)**	**281**	373	(125)	248
Financial liabilities						
– Derivative financial instruments (note 16)	**(164)**	**144**	**(20)**	(151)	125	(26)
	261	**–**	**261**	222	–	222

* No financial instruments have been offset in the Group Balance Sheet.

The Group is subject to master netting arrangements in force with financial counterparties with whom the Group trades derivatives.

The master netting arrangements determine the proceedings should either party default on their obligations. In case of any event of default: the non-defaulting party will calculate the sum of the replacement cost of outstanding transactions and amounts owed to it by the defaulting party. If that sum exceeds the amounts owed to the defaulting party, the defaulting party will pay the balance to the non-defaulting party. If the sum is less than the amounts owed to the defaulting party, the non-defaulting party will pay the balance to the defaulting party.

Notes on the accounts
continued

25 Cash flow

Cash generated from operations

	2013 £m	2012 Restated £m
Profit from operations	**5,526**	5,372
Adjustments for		
– amortisation of trademarks and similar intangibles	**74**	63
– amortisation of other intangible assets	**48**	53
– gain on deemed partial disposal of a trademark	**(26)**	–
– depreciation and impairment of property, plant and equipment	**355**	359
– increase in inventories	**(386)**	(755)
– increase in trade and other receivables	**(246)**	(329)
– increase in trade and other payables	**311**	840
– decrease in net retirement benefit liabilities	**(222)**	(160)
– decrease in provisions for liabilities and charges	**(19)**	(45)
– other non-cash items	**(49)**	39
Cash generated from operations	**5,366**	5,437

Profit from operations includes charges in respect of Group restructuring and integration costs referred to in note 3(e). These are also reflected in the movements in depreciation, amortisation, impairment, inventories, receivables, payables and provisions above and in the proceeds on disposal of property, plant and equipment shown in the Group cash flow statement. The cash outflow in respect of the Group's restructuring costs was £310 million (2012: £228 million).

Cash flows from investing activities

(a) Property, plant and equipment

In 2013, proceeds on disposal of property, plant and equipment include receipts in respect of Australia, Denmark and Russia, the gains on which have been included in restructuring and integration costs (note 3(e)).

In 2012, 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.

(b) 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 outflow in respect of current investments of £32 million (2012: £24 million inflow).

(c) Proceeds from associate's share buy-backs

The proceeds from associates' share buy-backs reflect proceeds of £189 million (2012: £262 million) in respect of the Group's participation in the share buy-back programme conducted by Reynolds American Inc.

(d) Purchase of subsidiaries

In 2013, the cash outflow relates to further cash consideration paid on the purchase of CN Creative Limited of £16 million. 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.

Cash flows from financing activities

(a) Cash flows from borrowings

In December 2013 a maturing £152 million bond was repaid, this repayment was financed from Group cash balances.

In November 2013 a maturing US$300 million bond was repaid, this repayment was financed from Group cash balances.

In September 2013 the Group issued a new £650 million bond with a maturity of 2026.

In July 2013 the Group repaid a maturing €519 million bond, this repayment was financed from Group cash balances.

In March 2013 the Group issued a new €650 million bond with a maturity of 2025 and a new US$300 million bond with a maturity of 2016.

During the year the Group's subsidiary in Brazil received proceeds of £399 million (2012: £356 million) from short-term borrowings in respect of advance payments on leaf export contracts and repaid £436 million (2012: £350 million).

At 31 December 2013 commercial paper of £521 million was outstanding (31 December 2012: nil).

In November 2012, the Group issued a new €750 million bond with a maturity of January 2023.

25 Cash flow continued

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.

(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 intercompany 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.

26 Business combinations, disposals and other changes in the Group

(a) CTBAT International Limited

On 30 August 2013 the Group announced that CTBAT International Limited (CTBAT), a joint investment incorporated in Hong Kong between subsidiaries of China National Tobacco Corporation (CNTC) and the Group, had commenced official business operations. The joint venture was created in accordance with the Joint Venture Agreement signed by both companies. It owns and manages the worldwide international cigarette trademark State Express 555, and also the worldwide rights outside China to the leading CNTC brand Shuang Xi.

CTBAT is treated as a joint operation as defined under IFRS 11 *Joint Arrangements*, and operates as an extension of the existing tobacco businesses of its investors. The Group will therefore recognise its share (50%) of the assets, liabilities, income and expenses of the arrangement on a line-by-line basis in the consolidated financial statements. CTBAT is reported as part of the Asia-Pacific region with the majority of its international sales (non-China domestic sales) made through existing BAT end markets in that region. All sales to mainland China are via CNTC.

In accordance with best practice, the contribution of brands and businesses into CTBAT have been recognised by the new entity at fair value, resulting in a gain on the deemed partial disposal of the State Express 555 brand which has been treated as an adjusting item (see note 3 (g)) and the recognition of the Group's share of the assets of the new business (see note 9).

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

(b) British American Tobacco Myanmar Limited

On 8 July 2013, the Group announced the completion of a joint venture in Myanmar with I.M.U. Enterprise Limited (IMU) to manufacture, distribute and market the Group's brands. Under the terms of the agreement, the Group has contributed plant and machinery and cash to the venture in return for a controlling stake, and will therefore account for the transaction as a business combination. The amounts involved, and the impact of the arrangement on operating results for 2013, are not material. Goodwill of £1 million in relation to the acquisition of the 51% stake in the business reflects the strategic premium to acquire the opportunity to re-enter the Myanmar market. The Group's proportion of the total net assets acquired at fair value amounted to £8 million with non-controlling interests of £8 million.

(c) CN Creative Limited

On 18 December 2012, the Group acquired CN Creative Limited, a UK-based start-up company specialising in the development of e-cigarette technologies. The company's entire share capital was acquired for £40 million, of which £14 million was paid in 2012 and a further £16 million paid during 2013. The remaining balance of the consideration payable is contingent upon the achievements of certain post-acquisition events. The only material asset acquired was the company's intellectual property.

(d) British American Tobacco Bangladesh

On 27 June 2012, the Group acquired a further 7% interest in British American Tobacco Bangladesh Company Limited at a cost of £24 million. This increased the Group's total shareholding to 73%.

(e) Items classified as held-for-sale

At 31 December 2013, held-for-sale assets comprise mainly land and buildings in Denmark which are being actively marketed for sale. At 31 December 2012, held-for-sale assets included land and buildings in Denmark and Russia which have been sold during 2013.

(f) 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.

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 10 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.

Deferred Share Bonus Scheme (DSBS)

Free ordinary shares released three years from date of grant and may be subject to forfeit if a participant leaves employment before the end of the three-year holding period. Participants receive a separate payment equivalent to a proportion of the dividend payment during the holding period. Both equity and cash-settled deferred shares are granted in March each year.

The Group also has a number of other arrangements which are not material for the Group and these are as follows:

Share Option Scheme (ESOS)

Options exercisable three years from date of grant with a contractual life of 10 years, subject to earnings per share performance condition relative to inflation. Participants are not entitled to receive dividends in the period prior to the exercise of the options.

The granting of options under this scheme ceased with the last grant made in March 2004 and final outstanding awards 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:

	2013		2012	
	Equity-settled £m	**Cash-settled £m**	Equity-settled £m	Cash-settled £m
LTIP (note (a))	**8**	**2**	22	5
DSBS (note (b))	**48**	**11**	46	13
SAYE (note (c))	**1**	**–**	1	–
SRS (note (c))	**4**	**–**	4	–
Total recognised in the income statement (note 3(a))	**61**	**13**	73	18

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 2013 and 2012:

	2013		2012	
	Vested £m	**Unvested £m**	Vested £m	Unvested £m
LTIP	**3.8**	**3.6**	3.0	8.6
DSBS	**0.2**	**14.7**	0.1	14.6
ESOS	**–**	**–**	0.2	–
Total liability	**4.0**	**18.3**	3.3	23.2

(a) Long-Term Incentive Plan

Details of the movements for the equity and cash-settled LTIP scheme during the years ended 31 December 2013 and 31 December 2012 were as follows:

	2013		2012	
	Equity-settled Number of options in thousands	**Cash-settled Number of options in thousands**	Equity-settled Number of options in thousands	Cash-settled Number of options in thousands
Outstanding at start of year	**5,949**	**779**	6,589	829
Granted during the period	**1,697**	**131**	1,834	303
Exercised during the period	**(1,508)**	**(179)**	(2,129)	(317)
Forfeited during the period	**(546)**	**(22)**	(345)	(36)
Outstanding at end of year	**5,592**	**709**	5,949	779
Exercisable at end of year	**770**	**123**	751	102

The weighted average British American Tobacco p.l.c. share price at the date of exercise for share options exercised during the period was £35.41 (2012: £31.96) for equity-settled and £34.97 (2012: £31.88) for cash-settled options.

The outstanding shares for the year ended 31 December 2013 had a weighted average contractual life of 7.8 years (2012: 8.0 years) for the equity-settled scheme, and 7.6 years (2012: 7.9 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 2013 and 31 December 2012 were as follows:

	2013		2012	
	Equity-settled Number of options in thousands	Cash-settled Number of options in thousands	Equity-settled Number of options in thousands	Cash-settled Number of options in thousands
Outstanding at start of year	**5,368**	**878**	6,109	954
Granted during the period	**1,628**	**158**	2,025	368
Exercised during the period	**(1,796)**	**(270)**	(2,667)	(431)
Forfeited during the period	**(95)**	**(12)**	(99)	(13)
Outstanding at end of year	**5,105**	**754**	5,368	878
Exercisable at end of year	**–**	**5**	45	2

The weighted average British American Tobacco p.l.c. share price at the date of exercise for share options exercised during the financial year was £34.96 (2012: £32.02) for equity-settled and £34.99 (2012: £32.01) for cash-settled options.

The outstanding shares for the year ended 31 December 2013 had a weighted average contractual life of 1.2 years (2012: 1.3 years) for the equity-settled scheme, and 1.0 years (2012: 1.3 years) for the cash-settled scheme.

(c) Other schemes

ESOS

The number of outstanding equity-settled options at the end of the year was 95,266 (2012: 204,002) and cash-settled options was nil (2012: 9,150).

SAYE

The number of outstanding options at the end of the year for the three-year scheme was 263,599 (2012: 280,383) and for the five-year scheme was 465,274 (2012: 526,023).

SRS and ISRS

The number of outstanding shares at the end of the year for the Share Reward Scheme was 546,983 (2012: 565,312) and for the International Share Reward Scheme was 41,205 (2012: 49,318).

Valuation assumptions

Assumptions used in the Black-Scholes models to determine the fair value of share options at grant date were as follows:

	2013		2012	
	LTIP	DSBS	LTIP	DSBS
Expected volatility (%)	**25**	**25**	26	26
Average expected term to exercise (years)	**3.5**	**3.0**	3.5	3.0
Risk-free rate (%)	**0.4**	**0.3**	0.7	0.6
Expected dividend yield (%)	**3.8**	**3.8**	3.9	3.9
Share price at date of grant (£)	**35.05**	**35.05**	32.08	32.08
Fair value at grant date (£)*	**23.69/23.44**	**31.23**	21.79/21.68	28.50

* 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:

	2013 %	2012 %
Average share price volatility FTSE 100 comparator group	**37**	39
Average share price volatility FMCG comparator group	**26**	26
Average correlation FTSE 100 comparator group	**37**	38
Average correlation FMCG comparator group	**37**	36

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 89,820 (2012: 87,485).

	2013 Number	2012 Number
Asia-Pacific	**17,156**	15,307
Americas	**16,489**	17,336
Western Europe	**11,824**	11,703
EEMEA	**12,261**	12,017
Subsidiary undertakings	**57,730**	56,363
Associates	**32,090**	31,122
	89,820	87,485

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 £86 million (2012: £84 million). The Group's share of dividends from associates, included in other net income in the table below, was £512 million (2012: £487 million).

	2013 £m	2012 £m
Transactions		
– revenue	**54**	32
– purchases	**(345)**	(330)
– other net income	**501**	481
Amounts receivable at 31 December	**96**	92
Amounts payable at 31 December	**(33)**	(34)

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.

During the year, the Group received proceeds of £189 million (2012: £262 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.

	2013 £m	2012 £m
The total compensation for key management personnel, including Directors, was:		
– salaries and other short-term employee benefits	**20**	22
– post-employment benefits	**3**	3
– share-based payments	**11**	10
	34	35

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 if 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.

Indemnity

On 30 July 2004, B&W completed the combination of the assets, liabilities and operations of its US tobacco business with R.J. Reynolds Tobacco Company ("RJRT"), a wholly-owned subsidiary of R.J. Reynolds Tobacco Holdings, Inc., pursuant to which Reynolds American Inc. was formed (the "Business Combination"). As part of the Business Combination, B&W contributed to RJRT all of the assets and liabilities of its US cigarette and tobacco business, subject to specified exceptions, in exchange for a 42% equity ownership interest in Reynolds American Inc.

As a result of the Business Combination, RJRT assumed all liabilities of B&W (except liabilities to the extent relating to businesses and assets not contributed by B&W to RJRT and other limited categories of liabilities) and contributed subsidiaries or otherwise to the extent related to B&W's tobacco business as conducted in the United States on or prior to 30 July 2004. In addition, RJRT agreed to indemnify B&W and each of its associates (other than Reynolds American Inc. and its subsidiaries) against, among other matters, all losses (including those arising from Environmental Tobacco Smoke (ETS) claims), liabilities, damages, expenses, judgments, attorneys' fees, etc., to the extent relating to or arising from such assumed liabilities or the assets contributed by B&W to RJRT (the "RJRT Indemnification").

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.

US litigation

The total number of US product liability cases pending at 31 December 2013 involving B&W was approximately 7,312 (compared to approximately 7,918 in 2012). Of these, 4,243 cases are RJRT Successor Cases. For all of the 7,312 cases involving B&W, British American Tobacco Group companies have the protection of the RJRT Indemnification. As at 31 December 2013, British American Tobacco (Investments) Limited ("Investments") has been served as a co-defendant in one of those cases (compared to one in 2012). No other UK-based Group company has been served as a co-defendant in any US product liability case pending as at 31 December 2013. Since many of these pending cases seek unspecified damages, it is not possible to quantify the total amounts being claimed, but the aggregate amounts involved in such litigation are significant, possibly totalling billions of US dollars. The cases fall into four broad categories: medical reimbursement cases; class actions; individual cases; and other claims.

(a) Medical reimbursement cases

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 2013, one US medical reimbursement suit was pending against B&W by an Indian tribe in an Indian tribal court in South Dakota. No other suits are pending against B&W by county or other political subdivisions of the states.

(b) Class actions

At 31 December 2013, B&W was named as a defendant in five separate actions attempting to assert claims on behalf of classes of persons allegedly injured or financially impacted through smoking or where classes of tobacco claimants have been certified. If the classes are or remain certified and the possibility of class-based liability is eventually established, it is likely that individual trials will be necessary to resolve any claims by individual plaintiffs. Class action suits have been filed in a number of states against individual cigarette manufacturers and their parent corporations, alleging that the use of the terms 'lights' and 'ultralights' constitutes unfair and deceptive trade practices.

Black is a 'lights' class action filed in November 2000 in the Circuit Court, City of St. Louis, Missouri. B&W removed the case to the US District Court for the Eastern District of Missouri on 23 September 2005. On 25 October 2005, the plaintiffs filed a motion to remand, which was granted on 17 March 2006. On 16 April 2008, the court stayed the case pending US Supreme Court review in Good v. Altria Group, Inc. On 28 June 2011, the court issued a memorandum removing the case from the trial docket.

Notes on the accounts
continued

30 Contingent liabilities and financial commitments continued

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. With appellate review completed and final judgment entered in the Scott class action, the trial court granted the plaintiffs' request to continue the stay of this action during the implementation of the Scott smoking cessation program on 6 March 2013.

In Engle (a case in Florida), a jury awarded a total of US$12.7 million to three class representatives, and in a later stage of the three-phase trial procedure adopted in this case, a jury assessed US$17.6 billion in punitive damages against B&W. On 21 May 2003, the intermediate appellate court reversed the trial court's judgment and remanded the case to the trial court with instructions to de-certify the class; this was upheld on 6 July 2006. Further, the Florida Supreme Court permitted the judgments entered for two of the three Engle class representatives to stand, but dismissed the judgment entered in favour of the third Engle class representative. Finally, the Florida Supreme Court permitted putative Engle class members to file individual lawsuits against the Engle defendants within one year of the court's decision (subsequently extended to 11 January 2008).

Engle progeny cases, as at 31 December 2013:

	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	43	4,229
Number of plaintiffs	99	5,104

Phase three trials of individual Engle class members, as at 31 December 2013:

	Additional Phase 3 Engle trials naming RJRT as successor to B&W proceeding to verdict
Total number of trials	52
Number of trials resulting in plaintiffs' verdicts	31
Total damages awarded in final judgments against RJRT as successor to B&W (approximately)	US$150,510,671
Amount of overall damages comprising 'compensatory damages' (approximately)	US$72,860,671 (of overall US$150,510,671)
Amount of overall damages comprising 'punitive damages' (approximately)	US$77,650,000 (of overall US$150,510,671)
Number of adverse judgments appealed by RJRT	30*
Number of adverse judgments (not yet appealed), in which RJRT still has time to file an appeal	0

* Of the 30 adverse judgments appealed by RJRT, nine were decided and/or closed, and 21 appeals remain undecided. 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 two of the appeals that were decided, the Florida intermediate appellate courts reversed the final judgment and remanded the matter to the trial court for a new trial on all issues. In another four appeals that were decided, the Florida intermediate appellate courts affirmed final judgments in favour of plaintiffs. In the final two appeals, RJRT has paid damages to the plaintiffs (in one: actual damages of US$450,000 and costs/fees/interest of US$2,390,011; in the other: damages of US$304,575) and the cases have been closed.

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 3 Engle progeny cases in the aggregate and establishing individual bond caps for individual cases in amounts that vary depending on the number of judgments in effect at a given time. In May 2011, Florida removed the provision in this legislation that would have permitted this bond cap to expire on 31 December 2012. Plaintiffs in several Engle progeny cases have unsuccessfully challenged the constitutionality of the bond cap. One of these appellate courts has since certified to the Florida Supreme Court the question of whether the bond cap violates the Florida Constitution. The Florida Supreme Court accepted jurisdiction over the issue of the constitutionality of the bond cap on 23 January 2012. On 31 August 2012, the Florida Supreme Court entered an order dismissing this case based on RJRT's mootness argument. Plaintiff subsequently moved for a rehearing. On 12 October 2012, the Florida Supreme Court denied plaintiff's motion. Plaintiff did not file a petition for writ of certiorari to the United States Supreme Court.

(c) Individual cases

	As at:	Total number of cases		
	31 December 2012	3,074		
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 2013	3,063	2,572	ETS cases brought by flight attendants who were members of a class action ("Broin") that was settled on terms that allow compensatory but not punitive damages claims by class members
			396	Cases brought in consolidated proceedings in West Virginia, where the first phase of the trial began on 15 April 2013 and on 15 May 2013 the jury returned a verdict for defendants on all but one of plaintiffs' claims; the verdict is currently on appeal
			43	Engle progeny cases that have been filed directly against B&W (please see earlier table on page 186)
			52	Cases filed by other individuals

In addition to the 4,229 Engle progeny cases which name RJRT as successor to B&W, there are 14 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 at 31 December 2013, one resulted in a verdict against B&W. In February 2005, a Missouri jury ("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 for additur, seeking 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 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. This application was granted on 18 December 2012.
On 10 September 2013, the Missouri Supreme Court affirmed the judgment of the circuit court. B&W filed a motion for rehearing on 25 September 2013, and that motion was overruled by the Missouri Supreme Court on 29 September 2013. On 7 November 2013, the court approved a confidential settlement.

Notes on the accounts
continued

30 Contingent liabilities and financial commitments continued

(d) 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, the 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, among other issues, various orders denying the defendants' claims of privilege over certain categories of documents during discovery.

The plaintiff filed his appeal on 25 January 2013 and the defendants' opposition and cross-appeal briefs were filed on 29 May 2013. The plaintiff filed his combined reply/response to Investments' cross-appeal on 19 July 2013. Investments filed a reply brief addressing the novel arguments raised in the plaintiff's reply/response relating to Investments' cross-appeal on privilege issues. The Court of Appeals heard oral argument in the case on 11 December 2013.

UK-based Group companies

Investments has been served in the following US cases pending as at 31 December 2013; one class action alleging violations of Kansas antitrust and consumer protection laws, the Daric Smith case mentioned above; and one individual action, the Perry case.

Product liability outside the United States

At 31 December 2013, active product liability claims against the Group's companies existed in 16 markets outside the US (2012:17) but the only markets with more than five claims were Argentina, Brazil, Canada, Italy and Nigeria. As at 31 December 2013, medical reimbursement actions are being brought in Argentina, Brazil, Canada, Nigeria and Spain.

(a) Medical reimbursement cases

Argentina

In 2007, the non-governmental organisation the Argentina Tort Law Association ("ATLA") and Emma Mendoza Voguet brought a reimbursement action against Nobleza Piccardo S.A.I.C.y.F. ("Nobleza") and Massalín Particulares. Several defences were filed by Nobleza on 1 October 2009. Nobleza and the federal government's preliminary objections regarding lack of jurisdiction were considered by the Civil Court in late 2009. On 23 December 2009, the Civil Court declared its lack of jurisdiction to hear the claim. On 11 March 2010, the case was sent to the Contentious-Administrative Court, which determined that it had jurisdiction over the case. On 24 June 2011, the Contentious-Administrative Court issued an Order stating that it would decide defendants' outstanding procedural objections together with the merits of the case.

The case is currently at the evidentiary stage. Confessional hearings took place on 14 August 2013 (Emma Mendoza Voguet) and 29 August 2013 (ATLA). A final decision is not expected before 2015.

Brazil

In August 2007, the São Paulo Public Prosecutor's office filed a medical reimbursement claim against Souza Cruz S.A. ("Souza Cruz"). A similar claim was lodged against Philip Morris. Souza Cruz's motion to consolidate the two claims was rejected and instead this case was removed to a different lower court. Souza Cruz filed a motion to reconsider the refusal for consolidation and an interlocutory appeal against assignment to the lower court. At the same time, the Public Prosecutor filed a motion challenging the connection between the two cases, which argument the State Court of Appeals accepted in August 2010 and ordered the two cases to progress independently. On 4 October 2011, the court dismissed the action against Souza Cruz, with a judgment on the merits. The plaintiff filed an appeal on 9 January 2012 and Souza Cruz filed its counter arguments on 17 February 2012. On 29 September 2012, the case records arrived at the São Paulo Court of Appeals.

On 7 March 2013, the case records returned from the Public Prosecutor's Office with a non-binding unfavourable opinion. On 23 April 2013, the Justices of the 2nd Civil Chamber of the Court of appeals of the State of São Paulo, by unanimous vote (3 to 0), denied the appeal of the Prosecution Office, thereby confirming the favourable Lower Court ruling. In this ruling, the Justices, citing case precedents of the Superior Court of Justice, emphasised: (i) the widespread public knowledge of the risks associated with smoking cigarettes; (ii) the free will of the smokers; (iii) the absence of any defect in the product; (iv) the absence of any duty to provide information on the risks associated with smoking before 1988; and (v) the lawfulness of manufacturing and producing cigarettes. To date, the Public Prosecutor's Office has not filed an appeal.

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 commenced an action.

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.	The underlying medical reimbursement action remains at a preliminary case management stage. Given the prior pendency of the Supreme Court application, and a number of other factors including delay on the part of the plaintiff in producing damages modelling materials, the trial date was adjourned generally and no trial date is currently set.
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. The parties are currently engaged in document production further to a consent order endorsed by the court on 6 May 2013. Damages have been quantified at CAN$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. On 30 May 2013, the Court of Appeal dismissed the appeals and upheld the adverse costs award in respect of the first instance hearing. A motion for leave to appeal that decision to the Supreme Court of Canada was filed in August 2013. The Supreme Court of Canada dismissed the leave application on 19 December 2013. On 22 October 2013, the Court of Appeal issued an endorsement awarding the plaintiff its costs of the appeals. Imperial filed a third-party notice against several native manufacturers claiming contribution and indemnity as well as damages in the amount of CAN$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. Following the Supreme Court of Canada's dismissal of the jurisdiction leave application, the case is under case management. There is a schedule in place for pleadings-related motions, with motions to strike set to be heard from 2–9 June 2014. Damages have been quantified at CAN$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.	There have been preliminary hearings, including a successful application in January 2012 to strike certain affidavits filed by the plaintiff in opposition to the UK Companies' jurisdiction motions, and a hearing in June 2013 at which, in response to a request of the case management judge, the parties debated the elements of the "legal framework" for a jurisdiction challenge. Judgment in respect of that hearing was issued on 19 December 2013. No further hearings or case management meetings have been scheduled.

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
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 an early case management stage. The UK Companies challenged the jurisdiction of the Saskatchewan court at a hearing that commenced on 29 April 2013. On 1 October 2013, the court denied the UK Companies' challenges. Leave to appeal this ruling was sought and a hearing was scheduled for 11 December 2013. This hearing was adjourned on consent of the parties pending the outcome of the Supreme Court of Canada leave application in the Ontario jurisdiction challenge. The leave application was dismissed on 19 December 2013. No further case management meetings have been set. Damages have not been quantified by the province. No trial date has been set. Imperial served a motion (which was granted) to defer filing defences until pending jurisdictional challenges have been resolved. There are no discovery motions to date in this jurisdiction.
Manitoba	Tobacco Damages Health Care Costs Recovery Act 2006	Imperial. Investments. Industries. Other former Rothmans Group companies.	Imperial served a motion (which was denied) to defer filing defences until pending jurisdictional challenges have been resolved. Imperial delivered a request for particulars on 30 September 2013. The province filed a response on 16 January 2014. The jurisdiction motions were scheduled to be heard on 25–28 November 2013. This hearing was adjourned on consent of the parties pending the outcome of the Supreme Court of Canada leave application in the Ontario jurisdiction challenge. The leave application was dismissed on 19 December 2013. No further case management meetings have been set. 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 and served.	On 8 August 2012, Imperial was served with the Alberta Medicaid suit. The UK Companies were served on 15 May 2013. The UK Companies informed the plaintiff that they intended to challenge the jurisdiction of the Alberta court. A case management judge has been appointed and an initial case management meeting was held on 17 December 2013 at which it was agreed to put preliminary matters on hold pending the outcome of the Supreme Court of Canada leave application in the Ontario jurisdiction challenge. The leave application was dismissed on 19 December. Case management is ongoing. Damages have been quantified at CAN$10 billion. No trial date has been set.

Canadian province	Act pursuant to which claim was brought	Companies named as defendants and date served	Current stage
Quebec	Tobacco Related Damages and Health Care Costs Recovery Act 2005	Investments, Industries, and Carreras Rothmans Limited have been named as defendants. Imperial and the UK Companies have been served.	On 25 August 2009, Imperial and the other Canadian manufacturers filed a constitutional challenge to the Quebec Medicaid Legislation. The Quebec Attorney-General (AG) filed a motion to dismiss the constitutional challenge and following a hearing, the Quebec Superior Court dismissed that motion. 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 CAN$60 billion. On 14 December 2012, Imperial's Motion to stay the Medicaid suit pending the resolution of the constitutional challenge, was heard by the Court and taken under advisement. It was subsequently dismissed. The Constitutional Challenge was heard on 30 September – 3 October 2013 and judgment remains under reserve. The three UK Companies filed jurisdictional challenges on 15 March 2013 which were heard on 3–5 June 2013. On 4 July 2013, the court denied the jurisdictional objections. Leave to appeal the ruling was refused in a judgment issued by a Court of Appeal judge on 4 October 2013. Defendants' motions for further and better particulars and concerning other pleadings issues were heard on 15 and 22 November and 20 December 2013 and judgment is reserved. A case management judge has been appointed. 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. Motions to challenge jurisdiction were filed and served by the UK Companies on 11 January 2013. A case management judge has been appointed but no date has been set for any case management conference or other hearing.

Notes on the accounts
continued

30 Contingent liabilities and financial commitments continued

Nigeria

As at 31 December 2013, six medical reimbursement actions filed by the federal government and five Nigerian states (Lagos, Kano, Gombe, Oyo, Ogun) were pending in the Nigerian courts. British American Tobacco (Nigeria) Limited, BAT and Investments have been named as defendants in each of the cases. The plaintiffs in the six cases seek a total of approximately £44.8 billion in damages, including special, anticipatory and punitive damages, restitution and disgorgement of profits, as well as declaratory and injunctive relief. On 13 and 25 May 2010, respectively, the plaintiffs in the Kano and Ogun state cases filed motions for preliminary injunctive relief, seeking, inter alia, orders to restrain the defendants from various alleged marketing and distribution practices including the sale of tobacco products within 1,000 metres of any public places that are predominantly locations for minors. BAT 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 BAT's and Investments' preliminary objections and set aside the service of the writ of summons. BAT and Investments appealed the court's order insofar as it denied the remainder of the relief requested, and the Court of Appeal has yet to set a date for hearing of the appeals.

The Federal High Court and the High Courts of Lagos, Kano, Gombe and Ogun states denied the preliminary objections filed by BAT 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 BAT and Investments. In the Gombe and Ogun cases, the High Courts have adjourned proceedings without date. As at 31 December 2013, the appeals filed by BAT and Investments remain pending in the Federal, Lagos, Kano and Gombe cases, and have yet to be heard by the Court of Appeal. On 23 April 2013 and 16 May 2013, the Court of Appeal (Ibadan Judicial Division) issued decisions affirming the Ogun High Court's denial of the preliminary objections filed by BAT, Investments and British American Tobacco (Nigeria) Limited. The companies have appealed the decisions to the Supreme Court of Nigeria.

Spain

In early 2006, the Government of Andalusia and the Andalusian Health Services (hereinafter referred to as the "Junta"), in Spain, filed a medical reimbursement action against the State and tobacco companies (including BAT España S.A.) before the contentious-administrative courts. The State filed preliminary objections to the Junta's claim, with tobacco companies filing supporting briefs. The court upheld these preliminary objections and dismissed the claim in November 2007. The Junta's appeal of this ruling to the Supreme Court was dismissed in September 2009. However, in May 2009, the Junta filed a new contentious-administrative claim with similar allegations. The defendants filed procedural objections, which were rejected by the court.

On 31 May 2013, the court notified BAT España of the commencement of a 20-day period to answer the Junta's claim and produced copies of the documents attached to the statement of claim. BAT España filed its response to the claim by the deadline of 27 June 2013.

By order dated 26 July 2013, the court refused to open the evidence phase of the proceedings. The court accepted the defendants' allegations that the Junta did not fulfil its procedural duty to establish the issues of fact to which the evidence would relate. In October 2013, the court declared the proceedings closed pending its judgment. In a judgment dated 23 December 2013, the court rejected the Junta's claim against the tobacco companies as inadmissible. It is open to the Junta to file an appeal against this judgment before the Supreme Court.

(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 court for production of evidence and a new judgment. On 19 March 2009, the Lower Civil Court ordered designation of court-appointed medical and advertising experts. The parties submitted questions to these court-appointed experts who subsequently delivered their reports. Each party also provided expert reports commenting on the court-appointed experts' conclusions. On 16 May 2011, the court granted Souza Cruz's motion to dismiss the action in its entirety on the merits. Plaintiffs filed an appeal of the dismissal on 22 July 2011. Souza Cruz filed its response on 5 October 2011. On 10 November 2011, the case records were sent to the Public Prosecutor's Office. On 20 December 2011, the Public Prosecutor's Office presented a non-binding, advisory opinion that rejected most of Souza Cruz's legal defence arguments. The case records were sent to the São Paulo State Court of Appeals and were immediately sent to the Public Prosecutor's office for General Public and Collective Interest.

On 1 March 2012, the case files returned with an unfavourable opinion given by the Public Prosecutor, who advised that the Court should find in favour of the appeal brought by ADESF and thereby fully reverse the appealed judgment. On 6 September 2012, the case was assigned to a new temporary Reporting Justice in the 7th Chamber of Private Law of the São Paulo Court of Appeals, pending reference to a permanent Reporting Justice of the case. On 10 October 2013, a Reporting Justice of the case was designated.

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 recognised the applicability of the special appeal and ordered it sent up to the Superior Court of Justice. On 5 June 2013, the Superior Court dismissed the interlocutory appeal filed by the Public Prosecution Office. On 7 June 2013, the case records were sent to 15th Civil Chamber of Rio Grande do Sul State Court of appeals and Justice Angelo Maraninchi Giammakos was designated as Reporting Justice. On 4 July 2013, the case records returned from the Public Prosecutor's Office with a non-binding favourable opinion, based on the free will and awareness of smokers, the fact that the products were not defective, and the lawfulness of manufacturing cigarettes. On 18 December 2013, the Rio Grande do Sul State Court rendered a decision in favour of defendants, based on free will, awareness and lawful activity. The plaintiff's right to appeal has not yet expired.

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. Instead it seeks compensation 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 who purchased in British-Columbia Imperial cigarettes bearing 'light' or 'mild' descriptors since 1974. Imperial filed an appeal against the certification which was heard in February 2006. The appellate court confirmed the certification of the class but has limited any financial liability, if proven, to 1997 onward.

The motion of the federal government to strike out the third-party notice issued against it by Imperial was upheld by the Supreme Court which dismissed the third-party claim on the basis that the federal government's impugned conduct constituted valid policy benefiting public health and was therefore not subject to civil liability.

Notes on the accounts
continued

30 Contingent liabilities and financial commitments continued

On 9 December 2009, Imperial was served with a class action filed by Ontario tobacco farmers and the Ontario Flue-Cured Tobacco Growers' Marketing Board ("Growers' claim"). The plaintiffs allege that, during a specific timeframe, Imperial and two other domestic defendants improperly paid lower prices for tobacco leaf destined for duty-free products that were then smuggled back into Canada and sold in the domestic market. In reaction to the suit, Imperial deposited the amount owing to the Government of Ontario, pursuant to the Comprehensive Agreement, into an escrow account, alleging that the Comprehensive Agreement permitted Imperial to set-off that amount against costs incurred as a result of the claim (including damages, if any). In response, the Ontario Government commenced an application against Imperial, seeking the release of the funds ("Ontario claim"). No monetary damages are being claimed against Imperial by the Government of Ontario.

On 26 July 2010, Imperial argued a preliminary motion in the Ontario claim seeking a stay in favour of arbitration given an arbitration clause in the Comprehensive Agreement. Imperial was successful in its application and the Court ordered that the Ontario claim be stayed. The Court of Appeal denied the Ontario Government's appeal in July 2011, but also ruled that the question of whether the Growers' Claim constitutes a "Released Claim" under the Comprehensive Agreement must be determined by the courts, thereby splitting the issues. On 2 January 2013, the Court rendered a decision in favour of Ontario and held that the Growers' claim is not a "Released Claim" brought by a "Releasing Entity". On 16 July 2013, the Court of Appeal dismissed Imperial's appeal on whether the Growers' claim is a "Released Claim" made by a "Released Entity", allowing the class action to proceed.

The question of whether Imperial may continue to set-off payments due to Ontario under the Comprehensive Agreement against costs incurred as a result of the Growers' claim remains a live issue and is proceeding to arbitration.

As a further preliminary challenge, Imperial has alleged that the Growers' claim is time barred. The other domestic defendants have made the same preliminary challenge. That preliminary issue was heard by Court on 30 and 31 January 2014. If Imperial is successful, the Growers' claim will be dismissed; if not successful, the action will proceed to a class action certification hearing.

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 CAN$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 15 cigarettes a day for at least five years, and residents who were addicted to nicotine at the time the proceedings were filed and who have since remained addicted. The plaintiffs' application to amend the scope of the definition of the disease and addiction classes was granted on 3 July 2013. In Quebec, there is no right of appeal for a defendant upon certification. 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. There are service issues in relation to the UK Companies in Alberta and Manitoba.

In July 2010, two further smoking and health class actions in British Columbia were served on Imperial and the UK companies. The Bourassa claim is allegedly on behalf of all individuals who have suffered chronic respiratory disease and the McDermid claim proposes a class based on heart disease. Both claims state that they have been brought on behalf of those who have "smoked a minimum of 25,000 cigarettes". The UK Companies objected to jurisdiction. Subsequently a number of the UK Companies were released from the action. No certification motion hearing date has been set.

In June 2012, a new smoking and health class action was filed in Ontario against the domestic manufacturers and foreign companies, including Imperial and the UK Companies. Imperial was served on 20 November 2012, and the UK Companies were served on 30 November 2012. The claim is presently in abeyance.

Italy

In or about June 2010, BAT Italia was served with a class action filed in the Civil Court of Rome by the consumer association, Codacons, and three class representatives. Plaintiffs primarily asserted addiction-related claims. The class action lawsuit was rejected at the first instance (Civil Court of Rome) and appellate (Rome Court of Appeal) court levels. In July 2012, Codacons filed an appeal before the Italian Supreme Court. BAT Italia filed its answer to the appeal on 13 November 2012. The parties are now waiting for the Supreme Court to schedule a hearing for the discussion of the case.

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, initially scheduled for 28 July 2009, where Cigarrera Bigott's status as a third party would be determined and parties would present evidence and make arguments.
On 16 September 2009, the Venezuelan Republic ordered the court to continue the judicial process.

On 12 April 2011, however, the Constitutional Chamber of the Supreme Court of Justice issued decision number 494, which established the rules for class action procedures. On 5 December 2012 Cigarrera Bigott was admitted as a third party and presented its defences and evidence on 26 February 2013. The parties will now be asked to attend a hearing at the Constitutional Chamber; however, no date for the hearing has yet been scheduled by the Court. On 9 October 2013 ASUSELECTRIC filed a petition requiring the Constitutional Chamber to schedule the hearing.

(c) Individual personal injury claims

As at 31 December 2013, the jurisdictions with the most number of active individual cases against Group companies were, in descending order: Brazil (164), Italy (22), Argentina (20), Canada (5), Chile (4) and Ireland (2). There were a further seven jurisdictions with one active case only.

Non-tobacco related litigation

Flintkote

The Flintkote Company ("Flintkote"), a US company formerly engaged in the production and sale of asbestos-containing products, was included in the acquisition of Genstar Corporation by Imasco Limited in 1986 and became a Group subsidiary following the restructuring of Imasco Limited (now Imperial Tobacco Canada Limited ("Imperial"), the Group's operating company in Canada) in 2000. Soon after this acquisition, and as part of the acquisition plan, Genstar Corporation began to sell most of its assets, including the non-asbestos related operations and subsidiaries of Flintkote. The liquidation of Flintkote assets produced cash proceeds and, having obtained advice from the law firm of Sullivan & Cromwell LLP ("S&C") and other advice that sufficient assets would remain to satisfy reasonably foreseeable liabilities, Flintkote's Board of Directors authorised the payment of a dividend of US$170.2 million in 1986 and a further dividend of US$355 million in 1987. In 2003, Imperial divested Flintkote and then, in 2004, Flintkote filed for bankruptcy in the United States Bankruptcy Court for the District of Delaware. In 2006, Flintkote, representatives of both the present and future asbestos plaintiffs (collectively, the "Flintkote Plaintiffs"), and certain individual asbestos plaintiffs (the "Hopkins Plaintiffs") were permitted by the Bankruptcy Court to file a complaint in the California State Court against Imperial and numerous other defendants, including a malpractice claim against S&C, for the recovery of the dividends and other compensation under various legal and equitable theories.

Following a multi-day bench trial, the California State Court issued a preliminary decision dismissing the claim against S&C. Before the decision was made final, Flintkote settled with S&C for a nominal sum. All claims and cross-claims in the litigation asserted by or against S&C have now been dismissed. After another series of bench trials, on 6 October 2011, the court issued preliminary orders deciding multiple preliminary issues regarding Flintkote's claims to recover the dividends and Flintkote's claim that Imperial is its "alter ego" for purposes of asbestos liabilities. Among other things, the court has concluded that Flintkote is barred from seeking to recover, under any theory, transfers that occurred after 31 December 1986. The court also concluded that Flintkote has no standing to pursue its claim that Imperial is its alter ego for purposes of asbestos liability, holding that any such claims must instead be pursued by individual asbestos plaintiffs. These rulings were made final on 6 January 2012. Thereafter, the Flintkote Plaintiffs agreed to dismiss certain of their claims, but continue to assert fraudulent conveyance claims and equitable restitution claims, as reflected in Third Amended Complaint filed in January 2013. In August 2013, the Court implemented certain of its earlier decisions by granting summary judgment to Imperial on the plaintiffs' claims to recover the 1987 dividends. The Court also granted summary judgment to Imperial on the plaintiffs' fraudulent conveyance claims that were based on allegations that Flintkote was insolvent at the time of the dividend. Nonetheless, Flintkote continues to pursue claims that effectively seek recovery of the value of 1987 dividend, and those claims will be the subject of further motion practice that is anticipated to occur in 2014. Procedurally, the claims of the Flintkote Plaintiffs are now separated from the claims of the Hopkins Plaintiffs, and it is anticipated that they will be tried separately. Additional discovery and motion practice is expected to occur throughout 2014.
The Court has not set a trial date, but a trial on the Flintkote Plaintiffs' claims could occur in late 2014 or early 2015. The alter ego claims of 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. Among the PRPs is NCR Corporation ("NCR").

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 Appvion Inc., ("Appvion"), 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 Appvion 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 application for a permanent injunction took place in December 2012 and the Court entered a permanent injunction against NCR. On 1 May 2013, the Wisconsin Court ruled that the pollution in the Fox River is not divisible. As a result of this and other decisions (referred to below), NCR is wholly responsible for the clean-up of those portions of the river. On 28 June 2013, NCR filed a notice of appeal against this judgment, and that appeal is pending in the United States Court of Appeals for the Seventh Circuit.

In a series of rulings, the Wisconsin Court has also held that NCR is not entitled to recover any amounts in contribution from other PRPs and that the other PRPs are entitled to recover Fox River clean-up costs from NCR. Cross-claims by Appvion against other PRPs to recover its own Fox River related expenditures were finally rejected by the Wisconsin Court on 25 June 2013. These orders are on appeal before the United States Court of Appeals for the Seventh Circuit.

A trial took place in Wisconsin in February 2012 to determine whether NCR is also liable for the clean-up costs in the upper portion of the Fox River. This trial addressed 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 upper portion of the river in the course of recycling the broke. A judgment issued in July 2012 found NCR was not liable on this basis and this order was made final on 27 June 2013. This decision is currently on appeal to the United States Court of Appeals for the Seventh Circuit.

In NCR's Form 10-Q Quarterly Report for the quarterly period ended 30 September 2013, the total clean-up costs for the Fox River are estimated at US$827 million. This estimate is subject to uncertainties and does not include natural resource damages which NCR estimates may range from US$0 to US$246 million (albeit the US Government in one court filing in 2009 indicated that natural resource damages could be as high as US$382 million).

Notes on the accounts
continued

30 Contingent liabilities and financial commitments continued

In 1978, a subsidiary of Industries, later known as Appleton Papers Inc. and now known as Appvion, purchased what was then NCR's Appleton Papers Division from NCR. In 1978, Industries also incorporated a US entity by the name of BATUS, Inc. ("BATUS"), which in 1980 became the holding company for all of Industries' US subsidiaries, including Appvion. As the holding company, BATUS obtained insurance policies for itself and its subsidiaries that included coverage for certain environmental liabilities. Industries/BATUS spun off the Appvion business in 1990 via a Demerger Agreement with Wiggins Teape Appleton p.l.c., now known as Windward Prospects Ltd ("Windward"), and Wiggins Teape Appleton (Holdings) p.l.c., now known as Arjo Wiggins US Holdings Ltd (collectively, the "AWA Entities"), obtaining what Industries believes were full indemnities from the AWA Entities and Appvion for past and future environmental claims.

Disputes between NCR, Appvion, and Industries as to the indemnities given and received under the original purchase agreement in 1978 have been the subject of litigation that was commenced in 1995, a settlement agreement effective from 1998 (the "Settlement Agreement"), and an arbitration award in 2005. NCR has taken the position that, under the terms of the Settlement Agreement and the arbitration award, Industries and Appvion generally have an obligation to bear 60% of the Fox River environmental remediation costs imposed on NCR, but Industries has never been required to pay any sums in this regard because, until May 2012, Appvion and the AWA Entities paid such costs, and the authorities have not identified Industries or BATUS as PRPs. Windward also has a separate and indirect indemnification obligation to Appvion in respect of the clean-up costs.

Subsequent to the preliminary injunction entered and affirmed against NCR in 2012, and by letters dated 3 May 2012, NCR made demands on both Appvion and Industries for payment of the sum of US$6.6 million, stated to be due on a joint and several basis pursuant to the terms of the Settlement Agreement and being 60% of costs paid by NCR so that remedial work could begin in accordance with the preliminary injunction. Appvion 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 Appvion. In a ruling handed down in September 2012 the court declined to enforce the terms of the Settlement Agreement and arbitration award, holding that the amount, of which Appvion is liable to pay 60%, must be ascertained via the dispute resolution provisions of the Settlement Agreement. Industries understands that NCR subsequently invoked the dispute resolution provisions contained in the Settlement Agreement as against Appvion, and on 29 March 2013 commenced an arbitration against Appvion seeking to recover incurred and on-going clean-up costs of at least US$39.9 million (plus interest and legal costs) and a declaration that Appvion is liable to NCR under the Settlement Agreement for 60% of all "Claims, Damages and Group Defence Costs" (as defined in the Settlement Agreement) it will incur. NCR has continued to make payment demands on Appvion since commencing the arbitration and, as at 15 November 2013, was seeking payment of approximately US$80.7 million from Appvion. Appvion sought to join Industries to the arbitration on the basis it was a necessary party and included a new claim that Industries is liable for 50% of Appvion's past liability and future liability to NCR under the Settlement Agreement. On 8 October 2013, the arbitral panel rejected Appvion's attempted joinder and the arbitration will proceed between NCR and Appvion only.

Industries is aware that Windward settled the majority of Appvion's insurance claims (over which it had control) at what Industries believes constituted a significant discount, and has made dividend payments to its former and current shareholders of approximately US$810 million, leaving it holding, according to its latest accounts, 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. Appvion's own accounts indicate limited financial resources.

It is possible, although Industries considers it unlikely, that French law could govern some of the claims Industries considers Windward has against its former shareholder, Sequana S.A. ("Sequana"), in relation to the dividend payments, which would mean that the limitation period in respect of those claims could have potentially expired in December 2013. In order to protect its position in the event that French law was held to govern the claims, Industries applied to the English Court on 2 October 2013 to seek to appoint a receiver over the relevant causes of action. Judgment was handed down on 21 November 2013. The judge held that absent an appropriate undertaking from Windward, receivers should be appointed in order to commence the dividend claims in the name of Windward and thereby protect the limitation position.

In addition to taking steps to protect claims which Industries considers Windward has against Sequana, Industries filed its own direct claims seeking to recover the dividend payments from Sequana in both the High Court of Justice of England and Wales (the "High Court") on 9 December 2013 and before the Commercial Court of Nanterre, France, on 13 December 2013.

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 in the High Court against both Windward and Appvion (which has also denied owing Industries an indemnity). Windward served its defence on 8 July 2013. Appvion has challenged the jurisdiction of the English Court and a hearing took place on 2 and 3 October 2013. Judgment was handed down on 20 December 2013. The Court dismissed Appvion's challenge, holding that the English Court should exercise its jurisdiction to hear the claim. The proceedings are now continuing in the English High Court against both Windward and Appvion. On 12 February 2014, Appvion served a Defence and Counterclaim. The Counterclaim seeks recovery of 50% of Appvion's previous clean-up related payments (alleged to be 50% of US$211.25 million, or US$105.6 million).

While Industries believes it may have defences to any claims brought by NCR against it under the Settlement Agreement and arbitration award, 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 £267 million (as at 31 December 2013) in relation to clean-up related costs. Accordingly, Industries has retained a provision of £267 million.

Industries is aware that NCR is also being pursued by Georgia-Pacific, as the owner of a facility on the Kalamazoo River in Michigan which released PCBs into that river. Georgia-Pacific has been designated as a PRP in respect of the river. Georgia-Pacific contends that NCR is responsible for, or should contribute to, the clean-up costs, because (i) a predecessor to NCR's Appleton Papers 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 took place in February 2013. On 26 September 2013, the Michigan Court held that NCR was liable as a PRP on the basis that broke sales constituted an arrangement for the disposal of hazardous material for the purposes of CERCLA. The decision was based on NCR's knowledge of the hazards of PCBs from at least 1969, but the court did not specify directly the entity(ies) whose broke sales form the basis of NCR's liability. NCR will have the ability to appeal the ruling once a final judgment has been entered or it has been otherwise certified for appeal. The second phase of the Kalamazoo trial, scheduled to commence on 28 July 2015, will determine the apportionment of liability among NCR, Georgia-Pacific and the other PRPs (International Paper Company and Weyerhauser Company). Industries anticipates that NCR may seek to recover from Appvion and/or Industries 60% of any Kalamazoo clean-up costs for which it is found liable on the basis, it would be asserted, that the river constitutes a "Future Site" for the purposes of the Settlement Agreement. Industries believes it may have defences to any such claim by NCR. The quantum of the clean-up costs for the Kalamazoo River is presently unclear (as is the extent of NCR's liability in respect of such costs), but could run into the hundreds of millions of dollars.

As detailed above, 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 particular quarterly or annual periods could be materially affected by this and by the final outcome of any particular litigation.

Having regard to all these matters, with the exception of Fox River, the Group (i) does not consider it appropriate to make any provision in respect of any pending litigation; and (ii) does not believe that the ultimate outcome of this litigation will significantly impair the Group's financial condition.

Tax disputes

The Group has exposures in respect of the payment or recovery of a numbers of taxes. The Group is and has been subject to a number of tax audits covering, among others, excise tax, value added taxes, sales taxes, corporate taxes, withholding taxes and payroll taxes.

The estimated costs of known tax obligations have been provided in these accounts in accordance with Group's accounting policies. In some countries, tax law requires that full or part payment of disputed tax assessments be made pending resolution of the dispute. To the extent that such payments exceed the estimated obligation, they would not be recognised as an expense.

The following matters may proceed to litigation:

Brazil

The Brazilian Federal Tax Authority has filed two claims against Souza Cruz seeking to reassess the profits of overseas subsidiaries to corporate income tax and social contribution tax. The first reassessment was for the years 2004–2006 in the sum of R$476 million (£122 million) to cover tax, interest and penalties. The second reassessment was for the years 2007 and 2008 in the amount of R$244m (£62 million) to cover tax, interest and penalties.

Souza Cruz appealed both reassessments and the matters are at the second tier administrative appeal process. Regarding the first assessment the Souza Cruz appeal was rejected although the written judgment of that tribunal is still awaited. The appeal against the second assessment was upheld at the second tier tribunal. There is one further administrative appeal level before the matter enters the judicial system.

Souza Cruz has decided not to participate in the tax amnesty programme (REFIS) announced by the Brazilian Government in 2013.

Notes on the accounts
continued

30 Contingent liabilities and financial commitments continued

Canada

The Canada Revenue Agency (CRA) has challenged the treatment of dividend income received by Imperial Tobacco Canada Ltd (ITCAN) from its investments in fellow group subsidiaries. The CRA and provincial tax authorities reassessed ITCAN for the years 2002 to 2005 in the sum of CAN$99 million (£56 million). ITCAN has appealed and paid the sum of CAN$58 million (£33 million) to enable it to pursue the appeal. The CRA has reassessed ITCAN for the years 2006–2009 in the sum of CAN$104 million (£59 million) and has accepted a letter of credit in the amount of CAN$58 million (£33 million) in lieu of payment. The provincial tax authorities are considering reassessments for the years 2006–2009 in the sum of CAN$53m (£30 million) and whether or not to accept letters of credit for CAN$32m (£18 million) in lieu of payment. The matter may proceed to litigation although no court date has yet been set.

South Africa

SARS has challenged the debt financing of British American Tobacco South Africa and reassessed the years 2006–2008 in the sum of R600 million (£35 million). BATSA has appealed the assessments and discussions with the authorities are ongoing.

The Group believes that the Group's companies have meritorious defences in law and fact in each of the above matters and intends to pursue each dispute through the judicial system as necessary. The Group does not consider it appropriate to make provision for these amounts assessed nor for any potential further amounts which may be assessed in subsequent years.

While the amounts that may be payable or receivable in relation to tax disputes could be material to the results or cash flows of the Group in the period in which they are recognised, the Board does not expect these amounts to have a material effect on the Group's financial condition.

Operating leases

Total future minimum lease payments under non-cancellable operating leases comprise leases where payments fall due:

	2013 £m	2012 £m
Property		
Within one year	**55**	56
Between one and five years	**114**	126
Beyond five years	**29**	49
	198	231
Plant and equipment		
Within one year	**25**	26
Between one and five years	**40**	37
	65	63

31 Interests in subsidiaries

Subsidiaries with material non-controlling interests

Non-controlling interests principally arise from the Group's listed investments in Brazil (Souza Cruz SA) and Malaysia (British American Tobacco (Malaysia) Berhad) where the Group holds 75% and 50% of the respective listed holding companies. Summarised financial information for these subsidiaries is shown below as required by IFRS 12 *Disclosure of Interests in Other Entities*. As part of the Group's reporting processes, both entities report consolidated financial information for their respective groups which have been adjusted to comply with Group accounting policies which may differ to local accounting practice. Goodwill in respect of Malaysia, which arose as a result of the acquisition of the Rothmans group referred to in note 9, has not been included as part of the net assets below. No adjustments have been made to the information below for the elimination of intercompany transactions and balances with the rest of the Group.

	Souza Cruz Group		Malaysia Group	
Summarised financial information	**2013** **£m**	2012 £m	**2013** **£m**	2012 £m
Revenue	**1,838**	1,946	**504**	452
Profit for the year	**504**	527	**167**	164
– *Attributable to non-controlling interests*	***126***	*130*	***84***	*82*
Total comprehensive income	**388**	457	**167**	164
– *Attributable to non-controlling interests*	***94***	*111*	***83***	*82*
Dividends paid to non-controlling interests	**(117)**	(114)	**(81)**	(76)
Summary net assets:				
Non-current assets	**424**	474	**61**	75
Current assets	**1,261**	1,414	**104**	119
Non-current liabilities	**(118)**	(163)	**(7)**	(59)
Current liabilities	**(908)**	(975)	**(152)**	(134)
Total equity at the end of the year	**659**	750	**6**	1
– *Attributable to non-controlling interests*	***181***	*207*	***3***	*1*
Net cash generated from operating activities	**588**	597	**166**	151
Net cash used in investing activities	**61**	(28)	**(5)**	(7)
Net cash used in financing activities	**(619)**	(502)	**(165)**	(190)
Differences on exchange	**(63)**	(97)	**(1)**	–
Decrease in net cash and cash equivalents	**(33)**	(30)	**(5)**	(46)
Net cash and cash equivalents at 1 January	**391**	421	**16**	62
Net cash and cash equivalents at 31 December	**358**	391	**11**	16

Other shareholdings

In Principal subsidiary undertakings, the Group discloses that it holds 85% of the equity shares of PT Bentoel Internasional Investama Tbk ('Bentoel'). In 2011, the Group sold 984 million shares, representing approximately 14% of Bentoel's share capital, for the purposes of fulfilling certain obligations pursuant to Bapepam LK (Indonesia) takeover regulations. The Group simultaneously entered into a total return swap on 971 million of the shares. As a consequence of this and for the duration of the swap, while the Group does not have legal ownership of these shares, it retains the risks and rewards which results in the Group continuing to recognise an effective interest in 99% of Bentoel's net assets and results.

Five-Year Summary

For the years ended 31 December	2013 £m	2012 Restated £m	2011 Restated £m	2010 Restated £m	2009 Restated £m
Income statement					
Gross turnover (including duty, excise and other taxes)	**46,185**	45,872	46,123	43,855	40,713
Revenue (after deducting duty, excise and other taxes)	**15,260**	15,190	15,399	14,883	14,208
Profit from operations	**5,526**	5,372	4,675	4,278	4,083
Adjusted profit from operations	**5,820**	5,641	5,473	4,944	4,443
Profit before taxation	**5,799**	5,592	4,870	4,334	4,049
Profit for the year	**4,199**	4,076	3,321	3,092	2,929

	2013 pence	2012 Restated pence	2011 Restated pence	2010 Restated pence	2009 Restated pence
Earnings per share					
– basic unadjusted	**205.4**	195.8	154.4	142.9	135.7
– diluted unadjusted	**204.6**	194.8	153.5	142.1	134.9
– diluted adjusted	**216.6**	205.2	191.9	173.4	151.6
Dividends declared per share	**142.4**	134.9	126.5	114.2	99.5

At 31 December	2013 £m	2012 £m	2011 £m	2010 £m	2009 £m
Balance sheet					
Non-current assets	**17,363**	18,141	18,624	19,203	18,508
Current assets	**9,518**	9,186	8,495	8,657	8,106
Total assets	**26,881**	27,327	27,119	27,860	26,614
Owners of the parent	**6,634**	7,472	8,167	9,206	7,613
Non-controlling interests	**301**	307	307	342	299
Total equity	**6,935**	7,779	8,474	9,548	7,912
Non-current liabilities	**11,510**	11,406	10,798	10,667	11,786
Current liabilities	**8,436**	8,142	7,847	7,645	6,916
Total liabilities	**19,946**	19,548	18,645	18,312	18,702
Total equity and liabilities	**26,881**	27,327	27,119	27,860	26,614

The information above has been restated, where applicable, to reflect the adoption of the revised IAS 19 *Employee Benefits* as explained in note 12.

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 2013 £m	31 Dec 2013 £m	31 Dec 2013 £m
Profit from operations	**2,807**	**2,719**	**5,526**
Analysed as:			
– adjusted profit from operations	**2,944**	**2,876**	**5,820**
– restructuring and integration costs	**(97)**	**(149)**	**(246)**
– amortisation of trademarks and similar intangibles	**(40)**	**(34)**	**(74)**
– gain on deemed partial disposal of a trademark	**–**	**26**	**26**
	2,807	**2,719**	**5,526**
Net finance costs	**(241)**	**(225)**	**(466)**
Share of post-tax results of associates and joint ventures	**425**	**314**	**739**
Analysed as:			
– adjusted share of post-tax results of associates and joint ventures	**368**	**355**	**723**
– issue of shares and change in shareholding	**27**	**(5)**	**22**
– restructuring and integration costs	**(2)**	**(2)**	**(4)**
– other	**32**	**(34)**	**(2)**
	425	**314**	**739**
Profit before taxation	**2,991**	**2,808**	**5,799**
Earnings per share			
Basic	**106.6p**	**98.8p**	**205.4p**
Diluted	**106.1p**	**98.5p**	**204.6p**
Adjusted diluted	**109.1p**	**107.5p**	**216.6p**

		6 months to	Year to
	30 Jun 2012 Restated £m	31 Dec 2012 Restated £m	31 Dec 2012 Restated £m
Profit from operations	2,722	2,650	5,372
Analysed as:			
– adjusted profit from operations	2,821	2,820	5,641
– restructuring and integration costs	(68)	(138)	(206)
– amortisation of trademarks	(31)	(32)	(63)
	2,722	2,650	5,372
Net finance costs	(211)	(245)	(456)
Share of post-tax results of associates and joint ventures	336	340	676
Analysed as:			
– adjusted share of post-tax results of associates and joint ventures	339	342	681
– issue of shares and change in shareholding	24	(4)	20
– restructuring and integration costs	(25)	1	(24)
– other	(2)	1	(1)
	336	340	676
Profit before taxation	2,847	2,745	5,592
Earnings per share			
Basic	97.8p	98.0p	195.8p
Diluted	97.3p	97.5p	194.8p
Adjusted diluted	101.3p	103.9p	205.2p

Principal subsidiaries and other Group undertakings
Principal subsidiary undertakings

The Company has taken advantage of the exemption under Section 410(2) of the Companies Act 2006 by providing information only in relation to subsidiary undertakings whose results or financial position, in the opinion of the Directors, principally affected the financial statements. The subsidiary undertakings listed below are therefore the main corporate entities in those countries which, in aggregate, contributed over 80% of Group revenue and profit from operations.

	% equity shares held
Centre Corporate Companies	
B.A.T (U.K. and Export) Ltd	100
B.A.T Capital Corporation (incorporated in the United States of America)	100*
B.A.T. International Finance p.l.c.	100*
BATMark Ltd	100*
British-American Tobacco (Holdings) Ltd	100
British American Tobacco Holdings (The Netherlands) B.V. (incorporated in The Netherlands)	100
British American Tobacco International Ltd (incorporated in Switzerland)	100
British American Tobacco (Brands) Inc (incorporated in the United States of America)	100
British American Tobacco (Brands) Ltd	100
British American Tobacco (GLP) Ltd	100
British American Tobacco (Investments) Ltd	100
Asia-Pacific	
Australia	
British American Tobacco Australia Ltd.	100
Bangladesh	
British American Tobacco Bangladesh Company Ltd	73
Indonesia	
PT Bentoel Internasional Investama Tbk	85
Japan	
British American Tobacco Japan, Ltd	100
Malaysia	
British American Tobacco (Malaysia) Berhad	50
New Zealand	
British American Tobacco (New Zealand) Ltd	100
Pakistan	
Pakistan Tobacco Co. Ltd	94
South Korea	
British American Tobacco Korea Ltd	100
British American Tobacco Korea Manufacturing Ltd	100
Taiwan	
B.A.T Services Ltd (incorporated in the United Kingdom)	100
Vietnam	
British-American Tobacco Marketing (Singapore) Private Limited (incorporated in Singapore)	100
Americas	
Argentina	
Nobleza-Piccardo S.A.I.C.y F.	99
Brazil	
Souza Cruz, S.A.	75
Canada	
Imperial Tobacco Canada Ltd	100
Chile	
British American Tobacco Chile Operaciones, S.A.	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 (House of Prince A/S)	100
France	
British American Tobacco France SAS	100
Germany	
British-American Tobacco (Germany) GmbH	100
British American Tobacco (Industrie) GmbH	100
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

	% equity shares held
Eastern Europe, Middle East and Africa	
Algeria	
British American Tobacco (Algérie) S.P.A.	51
Egypt	
British American Tobacco Egypt LLC	100
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
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 here that are held directly by British American Tobacco p.l.c. are indicated thus *; all others are held by sub-holding companies.

Unless otherwise stated, Centre Corporate Companies are subsidiary undertakings incorporated in the United Kingdom and the country of incorporation and operation of regional subsidiary undertakings is that under which the company is listed.

All identified subsidiary undertakings are involved in activities related to the manufacture, distribution or sale of tobacco products. All companies' shares are ordinary shares or common stock except for those indicated thus †, which include preference shares.

A complete list of Group subsidiary and associate undertakings will be attached to the next British American Tobacco p.l.c. annual return to the Registrar of Companies. A broader description of the Group's operations and sphere of activities can be found online at www.bat.com.

Principal joint operations

	% equity shares held
Asia-Pacific	
Hong Kong	
CTBAT International Ltd – tobacco	50

Principal associate undertakings

		Latest published information	Total issued capital £m	% shares held
Americas				
United States of America				
Reynolds American Inc.	[#] Common Stock	31.12.13	*	42.0
– tobacco	[#] Preferred Stock		**	
Asia-Pacific				
India				
ITC Ltd – FMCG including tobacco – agri-business – paperboard, paper and packaging – hotels	[#] Ordinary	31.12.13	77	30.5

[#] Listed overseas.

[*] As at 31 December 2013, Reynolds American Inc. had issued 538,053,024 shares (US$0.0001 Common Stock), of which the Group held 226,221,734.

[**] As at 31 December 2013, 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.

Report on the Parent Company financial statements

Our opinion

In our opinion the Parent Company financial statements:

- give a true and fair view of the state of the Parent Company's affairs as at 31 December;
- 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.

This opinion is to be read in the context of the remainder of this report.

What we have audited

The Parent Company financial statements, which are prepared by British American Tobacco p.l.c., comprise:

- the Parent Company Balance Sheet as at 31 December 2013; and
- the notes to the Parent Company financial statements, which include a summary of significant accounting policies and other explanatory information.

The financial reporting framework that has been applied in their preparation comprises applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

In applying the financial reporting framework, the Directors have made a number of subjective judgements, for example in respect of significant accounting estimates. In making such estimates, they have made assumptions and considered future events.

What an audit of financial statements involves

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) (ISAs (UK & Ireland)). An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of:

- whether the accounting policies are appropriate to the Parent Company's circumstances and have been consistently applied and adequately disclosed;
- the reasonableness of significant accounting estimates made by the Directors; and
- the overall presentation of the financial statements.

In addition, we read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited Parent Company financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinions on matters prescribed by the Companies Act 2006

In our opinion:

- The information given in the Strategic Report and the Directors' Report for the financial year for which the Parent Company financial statements are prepared is consistent with the Parent Company financial statements.
- The part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006.

Other matters on which we are required to report by exception

Adequacy of accounting records and information and explanations received

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- we have not received all the information and explanations we require for our audit; or
- adequate accounting records have not been kept by the Parent Company, or returns adequate for our audit have not been received from branches not visited by us; or
- the Parent Company financial statements and the part of the Directors' Remuneration Report to be audited are not in agreement with the accounting records and returns.

We have no exceptions to report arising from this responsibility.

Directors’ remuneration

Under the Companies Act 2006 we are required to report if, in our opinion, certain disclosures of directors’ remuneration specified by law have not been made. We have no exceptions to report arising from this responsibility.

Other information in the Annual Report

Under ISAs (UK & Ireland), we are required to report to you if, in our opinion, information in the Annual Report is:

- materially inconsistent with the information in the audited Parent Company financial statements; or
- apparently materially incorrect based on, or materially inconsistent with, our knowledge of the Parent Company acquired in the course of performing our audit; or
- is otherwise misleading.

We have no exceptions to report arising from this responsibility.

Responsibilities for the financial statements and the audit

Our responsibilities and those of the Directors

As explained more fully in the Directors’ Responsibilities Statement set out on page 112, 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 ISAs (UK & Ireland). Those standards require us to comply with the Auditing Practices Board’s Ethical Standards for Auditors.

This report, including the opinions, has been prepared for and only for the Company’s members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Other matter

We have reported separately on the Group financial statements of British American Tobacco p.l.c. for the year ended 31 December 2013 and on the information in the Directors’ Remuneration Report that is described as having been audited.

Paul Cragg (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London, United Kingdom

26 February 2014

Balance Sheet – British American Tobacco p.l.c.
At 31 December

	Notes	2013 £m	2012 £m
Assets			
Fixed assets			
Investments in Group companies	2	**4,350**	4,333
		4,350	4,333
Current assets			
Debtors	3	**8,101**	8,042
Cash at bank and in hand		**3**	–
Total current assets		**8,104**	8,042
Total assets		**12,454**	12,375
Equity			
Capital and reserves			
Called up share capital		**507**	507
Share premium account		**70**	67
Capital redemption reserves		**101**	101
Other reserves		**90**	90
Profit and loss account		**7,801**	7,575
after deducting			
– cost of treasury shares		**(4,309)**	(2,810)
Shareholders' funds	4	**8,569**	8,340
Liabilities			
Creditors	5	**3,885**	4,035
Total equity and liabilities		**12,454**	12,375

The accompanying notes are an integral part of the Parent Company financial statements.

On behalf of the Board

Richard Burrows
Chairman

26 February 2014

Notes on the accounts

1 Accounting policies

Basis of accounting

The Parent Company financial statements have been prepared on the going concern basis under the historical cost convention except as described in the accounting policy below on financial instruments and in accordance with the Companies Act 2006 and UK Generally Accepted Accounting Principles.

The Company is a public limited company which is listed on the London Stock Exchange and the Johannesburg Stock Exchange and is incorporated and domiciled in the UK.

Foreign currencies

Transactions arising in currencies other than sterling are translated at the rate of exchange ruling on the date of the transaction. Assets and liabilities expressed in currencies other than sterling are translated at rates of exchange ruling at the end of the financial year. All exchange differences are taken to the profit and loss account in the year.

Accounting for income

Income is included in the profit and loss account when all contractual or other applicable conditions for recognition have been met. Provisions are made for bad and doubtful debts, as appropriate.

Taxation

Taxation provided is that chargeable on the profits of the year, together with deferred taxation. Deferred taxation is provided in full on timing differences between the recognition of gains and losses in the financial statements and their recognition in tax computations. However, the Company does not discount deferred tax assets and liabilities.

Fixed asset investments

Fixed asset investments are stated at cost, together with subsequent capital contributions, less provisions for any impairment in value.

Dividends

Final dividend distributions to the Company's shareholders are recognised as a liability in the financial statements in the period in which the dividends are approved by the Company's shareholders while the interim dividend distributions are recognised in the period in which the dividends are declared and paid.

Similarly, dividend income is recognised at the same time as the paying company recognises the liability to pay a dividend.

Repurchase of share capital

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

Related parties

The Company has taken advantage of the exemption under paragraph 3(c) of FRS 8 from disclosing transactions with related parties that are wholly owned subsidiaries of British American Tobacco p.l.c. Group.

Financial instruments

The financial instrument disclosures of the Company are included in the Group financial statements which are included in this Annual Report. Consequently, the Company is exempt under paragraph 2D (b) of FRS 29 from publishing these financial instruments disclosures.

Financial guarantees are initially recorded at fair value, and subsequently carried at this fair value less accumulated amortisation.

Share-based payments

The Company has equity-settled share-based compensation plans.

Equity-settled share-based payments are measured at fair value at the date of grant. The fair value determined at the grant date of the equity-settled share-based payments is expensed over the vesting period, based on the Group's estimate of awards that will eventually vest. For plans where vesting conditions are based on total shareholder returns, the fair value at date of grant reflects these conditions, whereas earnings per share vesting conditions are reflected in the calculation of awards that will eventually vest over the vesting period.

Fair value is measured by the use of the Black-Scholes option pricing model, except where vesting is dependent on market conditions when the Monte-Carlo option pricing model is used. The expected life used in the models has been adjusted, based on management's best estimate, for the effects of non-transferability, exercise restrictions and behavioural considerations.

Future changes to accounting policies

On 22 November 2012, the Financial Reporting Council issued FRS 100 *Application of Financial Reporting Requirements* and FRS 101 *Reduced Disclosure Framework*. These were followed on 14 March 2013 by the publication of FRS 102 *The Financial Reporting Standard* applicable in the UK and Ireland. These standards will be applicable to all companies and entities in the UK and Republic of Ireland, other than listed groups, for accounting periods beginning on or after 1 January 2015. Early adoption is permissible.

FRS 100 sets out the overall financial reporting framework for companies in the UK and Ireland. FRS 101 applies to the individual financial statements of subsidiaries and ultimate parents, allowing them to apply the same accounting policies as in their listed group accounts, but with fewer disclosures. FRS 102 is a single financial reporting standard that applies to the financial statements of entities that are not applying EU-adopted IFRS, FRS 101 or the FRSSE. The primary statements of entities applying FRS 101 or FRS 102 would continue to follow the requirements of the Companies Act 2006.

The Directors are evaluating the impact of these requirements for the Company, and are likely to adopt the accounting requirements of the reduced disclosure framework under FRS 101 in the Company's reporting for 2015, but do not currently anticipate any material impact from doing so.

Notes on the accounts
continued

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.

	2013 £m	2012 £m
1 January	**4,333**	4,305
Additions	**17**	28
31 December	**4,350**	4,333

3 Debtors

	2013 £m	2012 £m
Amounts due from Group undertakings	**8,101**	8,042

Included within amounts due from Group undertakings is an amount of £8,024 million (2012: £7,750 million) which is unsecured, interest bearing and repayable on demand. The interest rate is based on LIBOR.

Amounts totalling £23 million (2012: £216 million) due from Group undertakings are unsecured, interest free and repayable on demand.

Included in debtors are amounts of £54 million (2012: £76 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 2013	**507**	**67**	**101**	**90**	**7,575**	**8,340**
Increase in share capital – share options	–	**3**	–	–	–	**3**
Profit for the year	–	–	–	–	**4,336**	**4,336**
Dividends and other appropriations ordinary shares	–	–	–	–	**(2,611)**	**(2,611)**
Consideration paid for share buy-back programme	–	–	–	–	**(1,509)**	**(1,509)**
Consideration paid for purchase of own shares held in employee share ownership trusts	–	–	–	–	**(69)**	**(69)**
Consideration received on the exercise of options over own shares held in employee share ownership trusts	–	–	–	–	**1**	**1**
Other movements	–	–	–	–	**78**	**78**
31 December 2013	**507**	**70**	**101**	**90**	**7,801**	**8,569**

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 2013 is shown in note 8 to the Group financial statements and will be recognised in the financial statements for the year ended 31 December 2014.

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 2013 was £4,336 million (2012: £4,727 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 2013 (2012: 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 £4,045 million (2012: £2,536 million) for shares repurchased and not cancelled and £264 million (2012: £274 million) in respect of the cost of own shares held in employee share ownership trusts.

During 2013, 44 million shares were bought back at a cost of £1,500 million (2012: 39 million shares at a cost of £1,250 million), excluding transaction costs of £9 million (2012: £8 million). As at 31 December 2013 treasury shares include 8,929,075 of shares held in trust and 139,516,345 of shares repurchased and not cancelled as part of the Company's share buy-back programme.

4 Shareholders' funds continued

Called up share capital	Ordinary shares of 25p each Number of shares	£m
Allotted and fully paid		
1 January 2013	**2,026,267,623**	**506.57**
Changes during the year		
– share option schemes	**188,783**	**0.04**
31 December 2013	**2,026,456,406**	**506.61**

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

Share premium

The increase of £3 million (2012: £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

	2013 £m	2012 £m
Amounts due to Group undertakings	**101**	250
Loans due to Group undertakings	**3,617**	3,617
Sundry creditors	**167**	168
	3,885	4,035

Amounts due to Group undertakings of £101 million (2012: £250 million) are unsecured, interest free and repayable on demand.

Loans due to Group undertakings of £3,617 million (2012: £3,617 million) are unsecured, bear interest at rates between 1.79% and 1.80% (2012: 1.87% and 2.14%) and are repayable in 2017.

Included in sundry creditors is an amount of £47 million (2012: £41 million) which is unsecured, interest free and due within one year and the remaining balance of £120 million (2012: £127 million) is unsecured, interest free and due after one year.

6 Audit fees

	2013	2012
Fees payable to PricewaterhouseCoopers LLP		
– Audit fees	**£30,000**	£30,000
– Fees paid for other services	**£nil**	£nil

7 Contingent liabilities and financial commitments

British American Tobacco p.l.c. has guaranteed borrowings by subsidiary undertakings of £11.3 billion (2012: £9.6 billion) and total borrowing facilities of £17.4 billion (2012: £17.4 billion).

There are contingent liabilities in respect of litigation in various countries (note 30 to the Group financial statements). In addition, the Company has cross-guaranteed the liabilities of the British American Tobacco UK Pension Fund which had a deficit according to the last formal tri-annual actuarial valuation in March 2011 of £516 million and which had a deficit on an IAS 19 basis at 31 December 2013 of £75 million (2012: £341 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
PO Box 43077, Providence, Rhode Island 02940-3077, USA
tel: 1-888 985-2055 (toll-free) or +1 781 575 4555
email enquiries: citibank@shareholders-online.com
website: www.citi.com/dr

Publications

Copies of current and past Annual Reports are available on request. Copies of the Group corporate brochure, Who We Are, 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 alert services for key financial events in the British American Tobacco financial calendar; download the British American Tobacco Investor Relations app to access all the latest financial information on your iPad, iPhone or Android.

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.

Final dividend 2013 – dates in 2014

Please see 'Other disclosures' (page 105) for further details.

27 February	Dividend announced (including amount of dividend per share in both sterling and rand, applicable exchange rate and conversion date – 25 February 2014; plus additional applicable information as required in respect of South Africa Dividends Tax)
27 February to 14 March	From the commencement of trading on 27 February to 14 March 2014 (inclusive), no removal requests in either direction between the UK main register and the South Africa branch register will be permitted
7 March	Last day to trade (JSE)
10 March to 14 March	From the commencement of trading on 10 March to 14 March 2014 (inclusive), no transfers between the UK main register and the South Africa branch register; no shares may be dematerialised or rematerialised
10 March	Ex-dividend date (JSE)
12 March	Ex-dividend date (LSE)
14 March	Record date (LSE and JSE)
8 May	Payment date (sterling and rand)

Financial calendar 2014

30 April	Interim Management Statement
30 April	Annual General Meeting The Banqueting House, Whitehall, London SW1A 2ER
30 July	Half-Yearly Report
22 October	Interim Management Statement

Analyses of shareholders

The high and low prices at which the Company's shares are recorded as having traded during the year on each of the LSE and the JSE are as follows:

	High	Low
LSE	£37.84	£30.91
JSE	R568.51	R431.49

At 31 December 2013 there was a total of 2,026,456,406 ordinary shares in issue held by 117,511 shareholders. These shareholdings are analysed as follows:

(a) by listing as at 31 December 2013:

Register	Total number of shares	Percentage of issued share capital	Number of holders
UK	1,713,380,735	84.55	49,029
South Africa	313,075,671	15.45	68,482

(b) by category of shareholder and size of shareholding as at 31 December 2013 (UK register) and 27 December 2013 (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	39,756	81.09	46,576,409	2.72
Financial institutions/ Pension funds	285	0.58	9,791,188	0.57
Nominee companies	8,731	17.81	1,512,208,331	88.26
Other corporate holders	256	0.52	5,288,462	0.31
Treasury Shares (UK)	1	<0.01	139,516,345	8.14

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	50,493	73.73	28,646,400	9.15
Financial institutions/ Pension funds	1,751	2.56	236,791,463	75.63
Nominee companies	13,585	19.84	33,714,853	10.77
Other corporate holders	2,653	3.87	13,922,955	4.45

Shareholder and contact information continued

Combined Registers

Category of shareholder	Number of holders	Percentage of total holders	Number of ordinary shares	Percentage of issued ordinary share capital
Individuals	90,249	76.80	75,222,809	3.71
Financial institutions/ Pension funds	2,036	1.73	246,582,651	12.17
Nominee companies	22,316	18.99	1,545,923,184	76.29
Other corporate holders	2,909	2.48	19,211,417	0.95
Treasury shares (UK)	1	<0.01	139,516,345	6.88

UK Register

	Number of holders	Percentage of UK ordinary share capital
1 – 1,999	41,043	1.15
2,000 – 9,999	6,101	1.34
10,000 – 199,999	1,358	3.57
200,000 – 499,999	234	4.37
500,000 and over	292	81.43
Treasury shares (UK)	1	8.14

South Africa Register

	Number of holders	Percentage of SA ordinary share capital
1 – 1,999	61,653	6.54
2,000 – 9,999	4,968	6.29
10,000 – 199,999	1,669	21.02
200,000 – 499,999	108	10.32
500,000 and over	84	55.83

Combined Registers

	Number of holders	Percentage of issued ordinary share capital
1 – 1,999	102,696	1.98
2,000 – 9,999	11,069	2.11
10,000 – 199,999	3,027	6.26
200,000 – 499,999	342	5.29
500,000 and over	376	77.48
Treasury shares (UK)	1	6.88

Registered office

Globe House, 4 Temple Place, London WC2R 2PG
tel: +44 20 7845 1000, facsimile: +44 20 7240 0555

Incorporated in England and Wales No. 3407696

Representative Office in South Africa

34 Alexander Street, Stellenbosch 7600, South Africa
PO Box 631, Cape Town 8000, South Africa
tel: +27 21 888 3077

Secretary

Nicola Snook

General Counsel

Neil Withington

Investor relations

Enquiries should be directed to Mike Nightingale, Rachael Brierley or Sabina Marshman
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