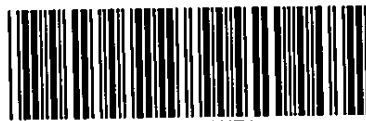


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Read the online Annual Report at
www.bat.com/ar2011

Annual Report 2011

About us

Our global business

For more information
please go to page 26

We are the world's second largest stock market listed tobacco group, with a responsible approach to doing business from crop to consumer in around 180 markets

Cigarettes sold by our Group companies in 2011

705bn

Growth in Global Drive Brand volumes in 2011

9%

Markets where we are leader

50+

Our brands

Our Global Drive Brands are Dunhill, Kent, Lucky Strike and Pall Mall, and in 2011 they provided around 35 per cent of Group revenue. Our other international brands include Vogue, Viceroy, Rothmans, Kool, Peter Stuyvesant, Benson & Hedges, State Express 555 and John Player Gold Leaf. Our brands are sold in around 180 markets worldwide.

For more information
please go to page 14

Our strategy

Our strategy is designed to deliver our vision of achieving leadership of the global tobacco industry and, as a result, build shareholder value. It is based on growth, funded by productivity and delivered by a winning organisation that acts responsibly at all times.

For more information
please go to page 10

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Our sustainability goals

British American Tobacco plc (No 3407696) Annual Report 2011
This is the Annual Report of British American Tobacco plc (the Company) and the British American Tobacco Group, comprising the Directors' report and the audited financial statements, for the year ended 31 December 2011. It has been drawn up and is presented in accordance with, and reliance upon, applicable English company law. The liabilities of the Directors in connection with this report shall be subject to the limitations and restrictions provided by such law.

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

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

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

From the Chairman

Dear shareholder

I am delighted to introduce the Annual Report on 2011, which has been a very successful year for your Company. While economic uncertainty continues, our operating environment improved during 2011. Our results for the year are driven by revenue growth, an improved operating margin, and growth in market share due to our successful brands, enhanced by the roll-out of product and packaging innovations.

Market share growth

Overall, industry volumes continued to decline in 2011 but there are signs that the rate of decline has moderated. Our own volumes were down marginally by 0.4 per cent and we grew market share during the year. These positive results were spread across many markets around the world.

The expansion of illicit trade is a continuing and growing threat to the business. Sharp increases in excise duty, pressure on consumers' disposable income, and ill-considered regulation of our industry, are all making life easier and more lucrative for traders of illicit products, both contraband and counterfeit.

Increasing returns to shareholders

Using constant currency exchange rates, revenue rose by 7 per cent on an organic basis. Adjusted profit from operations grew by 11 per cent to £5,519 million, or by 10 per cent at constant currency exchange rates.

This is reflected in adjusted diluted earnings per share for 2011 improving by 11 per cent to 194.6p.

The Board has recommended a final dividend of 88.4p per share, which will be paid on 3 May 2012 to shareholders on the register at 9 March 2012. This takes the total dividend for the year to 126.5p, an increase of 11 per cent on last year, and maintains our target of paying out 65 per cent of earnings in dividends.

In addition, following the suspension of our share buy-back programme in 2009, the Board approved the resumption of the programme in 2011. Between the beginning of March and the end of December 2011, some 28 million shares were repurchased at a value of £750 million, excluding transaction costs.

A continuation of the share buy-back to a value of £1.25 billion has been agreed by the Board.

Richard Burrows
Chairman

2011 has been a very successful year for your Company and we carry momentum in market share growth and margin improvement into 2012.

Board changes

Ana Mana Llopis retired from the Board after the Annual General Meeting in April 2011. Ann Godbehere, a Canadian, joined the Board as a Non-Executive Director on 3 October 2011. Paul Adams, former Chief Executive, retired at the end of February 2011 and was succeeded by Nicandro Durante who was introduced to shareholders in his new role at the AGM.

Christine Monn-Postel resigned as a member of the Audit Committee with effect from 21 February 2012 due to a personal conflict of interest, details of which are set out in the corporate governance statement.

Sustainability

Over the years we have built a strong reputation for corporate social responsibility and sustainability and have been recognised as leaders in our industry. For example, we were the first tobacco company to be included in the Dow Jones Sustainability World Index and we were included again in 2011. This focus on running our business responsibly helps us create value for our shareholders as well as being in the best interests of our other stakeholders.

Again this year, we publish our Sustainability Report alongside our Annual Report at the end of March. You will find a summary within this report that outlines the sustainability agenda we have been developing since 2007 and our progress against it in 2011. You can find more detail about this progress in our full Sustainability Report online at www.bat.com/sustainability.

Continued success

I express my thanks and appreciation to our Chief Executive, Nicandro Durante, to my fellow Directors on the Board, to management, and, in particular, to all our 56,000 colleagues around the world.

2011 has been a very successful year for your Company and we carry momentum in market share growth and margin improvement into 2012. The economic climate around the world is far from settled but we remain confident that our strategy should continue to generate growth for our shareholders in the years ahead.

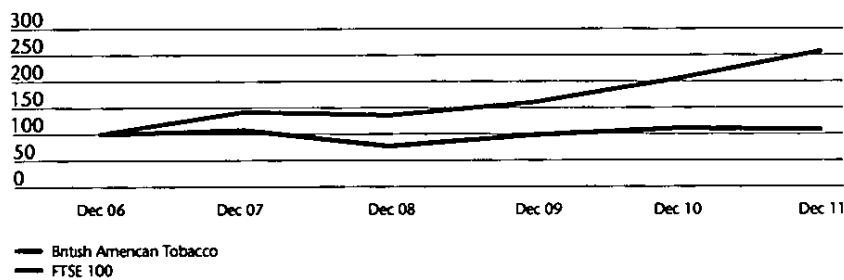
Richard Burrows
Chairman

2011 highlights

- Revenue rose by 7 per cent on an organic basis
- Adjusted profit from operations grew by 11 per cent
- Adjusted diluted earnings per share improved by 11 per cent to 194.6p
- Recommended dividend for the year of 126.5p, up 11 per cent on 2010

Historical total shareholder return

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



Over the five year period, our compound growth rate, based on adjusted diluted earnings per share, has been 14.7 per cent.

Results at a glance

Gross turnover (including duty, excise and other taxes) (£million)	46,123 +5%	
Revenue (£million)	15,399 +3%	126.5
Organic revenue ² at constant exchange rates ³ (£million)	15,453 +7%	+11%
Profit from operations (£million)	4,721 +9%	
Adjusted profit from operations ¹ (£million)	5,519 +11%	25.4%
Basic earnings per share (pence)	157.1 +8%	
Adjusted diluted earnings per share ¹ (pence)	194.6 +11%	
Dividends per share (pence)	126.5 +11%	
Free cash flow (£million)	3,326 +3%	
Group cigarette volumes, excluding associates (billion)	705 -0.4%	

FTSE 100 – 1 January 2009 to 31 December 2011
The FTSE 100 comparison is based on three months' average values

- Adjusted profit from operations is derived after excluding the adjusting items from the profit from operations. These adjusting items include restructuring and integration costs, amortisation and impairment of trademarks, goodwill impairment and Fox River provision.
- 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 2011 Group position.
- Constant currency provides the information based on a re-translation, at prior year exchange rates, of the current year information.

Chief Executive's review

Strong growth in revenue and profit

Nicandro Durante
Chief Executive

Our proven strategy continues to deliver

The strength of our brands, our consumer-centric innovative products and the quality of our people have delivered another year of very good earnings growth. The Group increased overall market share in 2010 and this continued in 2011 despite challenging economic conditions in some markets.

There are signs that the industry volume decline seen in recent years is moderating but substantial excise-driven price increases in a few markets continue to affect overall volumes. While industry volume declined again in 2011, our share improvement ensured that Group volumes were virtually unchanged, down just 0.4 per cent year on year.

Our Global Drive Brands and other international brands once again achieved good growth in 2011. Group revenue grew by 7 per cent on an organic basis and at constant rates of exchange, driven by continued good pricing. The resulting increase in adjusted profit from operations of 11 per cent has helped us to deliver superior returns to shareholders once again, with adjusted diluted earnings per share up by 11 per cent on last year.

Strong brands driving growth

Our brands, both international and local, performed well in 2011. Collectively, our four Global Drive Brands (GDBs) – Dunhill, Kent, Lucky Strike and Pall Mall – achieved volume growth of 9 per cent. Kent was up 10 per cent, growing in all of its top ten markets, Dunhill volumes were slightly higher, Pall Mall continued its recent success story with an 11 per cent increase in volumes, and Lucky Strike grew strongly by 14 per cent.

We continued to grow market share in 2011. This growth was driven by the launch of product innovations such as Click & Roll, Reloc and Convertibles in key markets, improved retailer relationships and by improving our speed to market.

Productivity

Our productivity continued to improve in 2011 as we further addressed our cost base through factory rationalisation, systems standardisation and productivity savings. This helped us achieve a substantial increase in operating margin from 33.5 to 35.8 per cent. This is well ahead of our target of improving overall margin by 50-100 basis points per annum.

Strengthening our business

In 2011 we grew market share, grew our leading international brands in our most important markets and achieved significant productivity savings. Our results demonstrate the strength of our companies worldwide but we know we can do better. Our tried and tested strategy has not changed but we will continue to improve how we execute it as we seek to grow market share.

Challenging ourselves to keep improving is critical to our continuing success, as we seek to grow market share by promoting our key brands and bringing market-leading innovations to market.

The last year has seen considerable success for the Group and I am excited when I look to our strengths. We have some great brands and our marketing is based on powerful consumer insights, supported by superior products and market-leading innovations.

Chief Executive's review continued

Sustainable business

Of course, much of what we do today is about preparing for our future. We are proud of our record of sustainability across our Group operations and throughout our supply chain. In particular, we are proud of our extensive scientific research programme looking at modified cigarettes and low-toxicant smokeless tobacco products.

Sustainability for us is about creating shared value, which means creating economic value for shareholders while ensuring our business is run responsibly in the interests of all our stakeholders.

We continue to make progress on our sustainability agenda, not just reducing our impact on the environment and investing in our people but also the way we conduct our operations in the marketplace and throughout our supply chain.

Our key challenge for many decades to come will be to provide tobacco consumers with exciting high quality products, taking into account their changing preferences and expectations.

This means continuing to deliver the most innovative cigarette products, as we do today. It also means developing other nicotine products consumers may choose in the future. In 2011, we set up Nicoventures as a stand-alone company to develop and test alternative nicotine products. We believe that the debates around our product categories should be founded on fact-based science and we have made a significant commitment to this at our Group research and development facilities, where the work we are doing trying to develop lower toxicant products has been recognised by several key stakeholders.

Global outlook

For the foreseeable future, the world market is likely to remain fairly stable at around five and a half trillion cigarettes, more than 40 per cent of which are sold in China. We expect overall market values to grow due to changes in the product mix and we believe the value of emerging markets will grow more quickly. Because of this, our geographic diversity and strong positions in emerging markets remain a key strength.

Managing risks

We have identified a core list of potential threats that we believe could represent significant risks to our business. As can be seen from our review of the key Group risk factors in this report, we regularly monitor their potential impact and likelihood and controls are in place to ensure that they are carefully managed.

Tackling illicit trade

The expansion of illicit trade remains a threat globally, driven by sharp excise increases and pressure on consumers' disposable income. We support the development of the World Health Organisation's Framework Convention on Tobacco Control (FCTC) protocol aimed at creating an international regulatory framework for addressing illicit trade. However, we remain critical of other measures proposed by the FCTC that may drive significant excise increases, retail display bans and plain packaging – all of these measures could play into the hands of organised crime by creating ideal conditions for further increases in illicit trade.

Acquisitions and competitive landscape

The tobacco industry remained fairly stable during 2011, with little M&A activity among the leading industry players. On 26 May 2011, the Group announced that it had agreed to acquire 100 per cent of privately-owned Protobaco, the second largest cigarette company in Colombia. The transaction was completed on 11 October 2011 and the deal was financed from internal resources.

We continue to monitor acquisition opportunities around the world and will participate where it makes financial and strategic sense to do so.

Management Board changes

2011 saw the retirement of my predecessor, Paul Adams, as well as that of our long-standing Group Operations Director, Peter Taylor. Des Naughton replaced Peter, while Giovanni Giordano succeeded Rudi Kindts as Group Human Resources Director.

In November 2011, I announced that Michael Prideaux, Director, Corporate & Regulatory Affairs (CORA), had informed the Board of his intention to retire with effect from 30 June 2012. At the same time, I was pleased to announce the appointments of Kingsley Wheaton, Dr David O'Reilly and Naresh Sethi to the Management Board. Kingsley became Deputy CORA Director with effect from 1 January 2012 and will take the role of CORA Director when Michael retires. Also from 1 January 2012, David and Naresh took on the newly created roles of Group Scientific Director and Director, Group Business Development, respectively.

I would like to extend my personal thanks to our retiring directors for their excellent contributions to our business over many years and welcome our new directors.

Substantial opportunities

The last year has seen considerable success for the Group and I am excited when I look to our strengths.

We have some great brands and our marketing is based on powerful consumer insights, supported by differentiated and superior products. We have market-leading innovations – and we are getting better at deploying them. We have a great business mix, with a strong presence in emerging markets and a balanced product portfolio across all segments. We have a fully integrated supply chain and our systems are becoming more efficient. We have an industry-leading approach to science and harm reduction and, importantly, we have the people capable of tackling the challenges ahead.

I am confident that we are well placed to take advantage of the substantial opportunities ahead for our business and that we can continue to deliver superior shareholder returns.

Nicandro Durante
Chief Executive

2011 highlights

- **Our overall market share grew**
- **Global Drive Brand volumes grew by 9 per cent**
- **Innovations continue to drive growth**
- **Operating margin increased substantially to 35.8 per cent**
- **We acquired Protabaco, the second largest tobacco company in Colombia**
- **Nicoventures was launched as a stand-alone company to develop alternative nicotine products**

Global market overview

Value of the global tobacco market continues to grow

Global tobacco market

- **Estimated value of £450 billion**
- **Cigarettes account for around 95 per cent of the total market**
- **Around 5.5 trillion cigarettes produced each year**
- **Overall cigarette volumes (excluding China) declined by around 2 per cent in 2011 but the overall market value continues to grow**
- **Up to 12 per cent of global volume is illicit – fake, smuggled or local tax-evaded**

Global marketplace

The global tobacco market is valued at around £450 billion and the industry produces around 5.5 trillion cigarettes a year. While cigarette sales in developed countries continue to decline slightly year on year, overall global market declines are showing signs of moderating. Recent trends indicate that individual smokers will consume fewer cigarettes each and smaller percentages of populations will smoke. However, sustained volume growth is widely predicted in emerging markets, driven by population growth and increasing disposable income.

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

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

Tobacco companies face an increasingly competitive marketplace but the overall value of the global market continues to grow. This value is expected to exceed £500 billion by 2015, despite tighter regulation, global economic uncertainty and high unemployment levels in developed markets. Consumers worldwide are increasingly looking for and expecting real value, meaning that quality and innovation will both play a growing role in delivering market share.

British American Tobacco's total cigarette volume for 2011 was 705 billion. Our estimated share of the global market was 13 per cent.

The breakdown by region was: Asia-Pacific 191 billion, Americas 143 billion, Western Europe 135 billion, and Eastern Europe, Middle East and Africa 236 billion.

For more information see our regional review on page 26.

Illicit trade

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

Estimates suggest that up to 660 billion illegal cigarettes are smoked every year. This has a negative impact on consumers, retailers, governments and tobacco companies. For consumers, counterfeit cigarettes mean no quality controls and no health warnings, while smuggled genuine products may carry health warnings that do not meet local government regulations.

As illegal cigarette sales are effectively unregulated, criminals also have no qualms with providing anyone with their products, including underage smokers.

It is estimated that governments worldwide are losing up to US\$40 billion a year in excise and other taxes. Tackling this illegal trade effectively requires cooperation between the industry, regulators and enforcement authorities, backed up by the establishment of appropriate tax policies, strong regulation and effective enforcement.

Illegal cigarettes – who's paying the price?

British American Tobacco produced a short film in 2011 called 'This is the man' and made it available on its corporate website and via YouTube. The film illustrates how the black market in tobacco products is increasingly dominated by organised crime. Law enforcers say some gangs are also behind people trafficking, prostitution, gun and drug crime. They may even have terrorist links. Some regulatory policies could see an increase in illicit trade, so this film asks: 'Illegal cigarettes – who's paying the price?'

Increasing regulation

Much of the tobacco regulation being proposed and introduced around the world is driven by the World Health Organisation's Framework Convention on Tobacco Control (FCTC) protocol. However, most of these measures are not based on strong evidence that they are likely to reduce smoking. Indeed, small declines in legitimate companies' tobacco volumes in recent years have been largely offset by the increase in illicit trade.

Extreme regulation often has unintended consequences. For example, legislation to introduce plain packaging for tobacco products in Australia could damage the livelihoods of small retailers and make criminals' lives easier. Counterfeit products could become easier to produce and non-compliant branded illicit products could become more attractive to consumers. Other measures, such as retail display bans and sudden increases in excise rates, can distort competition among tobacco companies and, in some cases, may result in consumers switching to cheaper illicit products.

Overall, demand for tobacco products tends to remain fairly stable in the face of price rises. Further marketing restrictions, combined with existing brand loyalty, mean that major changes to the competitive landscape in the tobacco industry are unlikely for some time.

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

Deloitte report

In 2011, British American Tobacco commissioned a report by Deloitte to examine the intended and unintended impacts of packaging regulation. The report assessed 27 countries covering a period of 14 years and is one of the most comprehensive independent studies on tobacco packaging regulation to date.

We commissioned the report in the absence of any comprehensive global studies on the impacts of tobacco packaging and we hope governments will study it and find it a useful contribution to the debate.

The report revealed that neither increasing the size of health warnings on packs nor introducing graphic images had directly reduced tobacco consumption. It also recognised that the plainer the pack, the easier it is to counterfeit.

You can read the report at www.bat.com/deloitte

Our strategy

Strategy for building shareholder value

Our strategy and business model drive our global operations, supported at all times by good corporate governance. The strength of our people and brands; the innovations that help differentiate our products in around 180 markets; our agile and responsible supply chain; and our science-based R&D – these all contribute to the revenue growth that helps build value for our shareholders.

Our vision

Growth

Productivity

Winning organisation

Responsibility

Our vision

Our Group vision is to achieve leadership of the global tobacco industry, not just in volume and value, but also in the quality of our business. To be industry leaders we must continue to demonstrate that we are a responsible tobacco Group with outstanding people, brands and superior products.

Growth

Our strategy to deliver our vision begins with growth and our aim to increase our global market share, with a focus on our Global Drive Brands and our other international brands.

For more information please go to page 12

Productivity

We target continuous improvements in our cost base that will provide resources to invest in our brands, helping us to grow market share and achieve higher returns for shareholders.

For more information please go to page 15

Winning organisation

By being a winning organisation we can ensure that we attract, develop and retain the best people we need to deliver our strategy for growth.

For more information please go to page 16

Responsibility

Our companies and people are required to act responsibly at all times and we seek to reduce the harm caused by our products and our environmental footprint.

For more information please go to page 17

Our business model

Our business model is designed to deliver sustainable growth in earnings. It is consumer-led and science-based.

How our business works

Consumers

Our success depends on really understanding the different profiles and preferences of our consumers. We invest in gathering comprehensive insights into smokers' preferences and buying behaviour. This drives our marketing and allows us to promote our products to adult tobacco consumers in ways that satisfy their preferences, while responding to stakeholder expectations about how we should market our products.

Sourcing

We have a significant interest in tobacco growing and we work directly with around 70 per cent of the farmers who supply our leaf. We manage our whole supply chain responsibly and work with our suppliers to create a shared understanding of our social, environmental and economic impacts. This enables us and our suppliers to manage risks better, while ensuring that we are agile and flexible, so that we can use our resources as effectively as possible.

Production

Manufacturing tobacco products is a large-scale operation and we have factories all over the world. We work to ensure that our costs are globally competitive and that we use our resources as effectively as possible. Our companies have closed or downsized some factories and consolidated production elsewhere in recent years. These changes enable us to rationalise our machinery and technology to establish a more cost-effective operational base for the future.

Worldwide presence

Our international reach and well-developed distribution channels are critical enablers of our growth strategy, allowing us to roll out innovations on a global scale. We continuously review our route to market to ensure we remain competitive. This includes our relationships with wholesalers, distributors and logistics providers, as well as our direct to store sales operation, which is often the most effective way of serving retailers and building business partnerships.

Building sustainable value

Science-based R&D

For over 50 years, we have had an extensive scientific research programme. More recently, we have been focusing research on modified cigarettes and low-toxicant smokeless tobacco products. We are committed to helping develop the scientific and regulatory framework we need to deliver a varied portfolio of products in the future, including alternative regulatory-approved nicotine products, to meet the evolving needs of adult smokers.

Brands

We have a successful brand marketing strategy based on innovation, responsibility and consumer choice. We recognise that our business starts with our consumers and our brand portfolio is designed to meet key consumer needs, especially in our strategic consumer segments. Our four Global Drive Brands – Dunhill, Kent, Lucky Strike and Pall Mall – and our other international brands account for more than 50 per cent of our total cigarette volumes.

Innovative products

We make significant investment in our brands and the development of superior, differentiated products to drive growth. Our product and packaging innovations, such as Convertibles and Reloc, vary across our brands, brand variants and markets and our approach enables our companies to adapt their offers flexibly to local preferences. Our focus when designing these innovations is on relevance to the consumer and potential speed to market.

Our people

We employ more than 56,000 people worldwide – from securing our leaf supply through production and distribution to our efforts to develop reduced-risk products. Our workforce is strongly multi-cultural and we have a devolved structure, with each local company having responsibility for its operations. We value our employees' talents and diverse perspectives and recognise their critical role in achieving the goals we set for our business.

Strategic review

Our strategy in action

Our consistent strategy for delivering our vision is based on growth, funded by productivity and delivered by a winning organisation that acts responsibly at all times.

Growth

We continued to achieve sustainable, profitable growth in 2011, driven by a better deployment of innovations and an emphasis on improving the execution of our strategy

Our Global Drive Brands (GDBs) and other international brands continued to contribute strongly to our business performance. Our balanced portfolio, deployed across a wide range of markets and segments and driven by innovation, continues to provide a successful formula for growth

In October we completed our acquisition of Productora Tabacalera de Colombia, S.A.S (Protabaco) for an enterprise value of US\$461 million, subject to final agreement. Colombia is Latin America's fourth largest cigarette market and the acquisition elevates our subsidiary company's market share to almost 50 per cent.

Strong growth driven by GDBs

Overall GDB volume grew by 9 per cent in 2011, driven by the expansion of GDBs into new markets and the roll-out of

consumer-relevant innovations, particularly capsules. Since 2005, the GDB share of our global volumes has increased from 18 per cent to 32 per cent

Kent performed very strongly in 2011 across all regions. Global volume grew by 10 per cent to a record 67 billion cigarettes. This robust performance has been achieved through share gains in many key markets such as Russia, Ukraine and other eastern European markets. Kent also grew in Japan, Chile and Romania, as well as the Middle East and Vietnam

Kent Convertibles, the innovative range of capsule products launched in nine markets in 2010, was rolled out to a further 14 markets in 2011. Convertibles have played a key role in generating volume growth and reinforcing Kent's status as a leader in innovation. Packaging improvements implemented across our core range strengthened the brand and resulted in share gains and Kent Nanotek continued to be the fastest growing range in the Kent portfolio

Lucky Strike delivered global volume growth of 14 per cent in 2011 — a significant acceleration and a record for the brand. The results were evenly balanced between organic growth of the existing product range and new innovations. The continued global roll-out of Click & Roll following its launch in 2010 more than doubled its annual volume, with record market share in Brazil, Argentina, France and Chile

In 2011, Lucky Strike also added a new dimension to the brand with the launch of an 'all-natural' offer. This has achieved segment leadership in Germany within one year, and is re-energising the brand's growth in its largest markets

Dunhill, our most prestigious brand, delivered strong organic growth in 2011 across most of our strategic markets, driven primarily by innovation. However, overall volume performance was negatively affected by share loss in South Korea due to competitive pricing. Overall, Dunhill volume including South Korea increased slightly in 2011, following 18 per cent growth in 2010. Excluding South Korea growth was 8 per cent.

Dunhill has driven premium innovation growth through Fine Cut Reloc, Capsule Reloc and Kingsize Reloc. Strong growth markets in 2011 included Brazil, the Gulf Cooperation Council (GCC), Malaysia, Romania, Taiwan, Nigeria, Indonesia, Egypt and Serbia.

Pall Mall, our biggest value-for-money brand, delivered volume growth of 11 per cent in 2011. This was driven mainly by significant share growth in Pakistan, as well as growth in Germany – where Pall Mall is the number one Adult Smokers Under 30 (ASU30) brand – Canada, Chile and Serbia.

Local and international brands perform well

Our other international brands include Vogue, Viceroy, Rothmans, Kool, Peter Stuyvesant, Benson & Hedges, State Express 555 and John Player Gold Leaf.

In 2011 our international brands had good successes, such as Kool in Japan and Viceroy in Poland. Rothmans, our eighth largest brand, broke the 20 billion cigarette mark in 2011 with a strong performance in Egypt.

Our international brands, including our GDBs, accounted for 53 per cent of Group volume in 2011.

Key local brands with high consumer loyalty such as Yava in Russia and Derby and Free in Brazil continue to play an important role in our brand strategy, as they help us maintain a broad portfolio.

Trade marketing and distribution

Our Trade Marketing & Distribution (TM&D) teams are responsible for the selling and delivery of our products to retail outlets, the presence of our brands at the point of sale and the development of mutually beneficial partnerships with

our retail customers. This includes engagement in the prevention of youth smoking and illicit trade.

Our people

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

Route to market

Our route to market is critical and allows us to roll out innovations faster on a global scale as well as to fully meet consumer demand at the point of sale.

Where appropriate, we believe that direct to store sales (DSS) are an effective way of serving retailers and building sustainable business partnerships. DSS gives us visibility and control over the sales and distribution process, allowing us access to both the market and consumer information. It also provides a direct commercial link to our most strategic retail accounts. Half of our global volume is sold to retailers through our own distribution capability in key markets including Canada, Brazil, South Korea, Australia, Russia, Romania, South Africa and Nigeria.

In other markets, we work with third parties to ensure our products are effectively sold and delivered to retailers.

Customer management

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

In 2011, we further developed joint programmes with our global retail partners in order to better reach adult smokers in key channels such as global travel retail and convenience.

We sold over 9 billion capsule cigarettes in 2011, mainly through Kent Convertibles, Kool Boost, Lucky Strike Click & Roll and Dunhill Switch.

Reloc is Dunhill's exclusive range of packs that deliver the best tobacco at optimal freshness.

Strategic review continued

Global Drive Brands 2011

Lucky Strike	Pall Mall	Kent	Dunhill
Cigarettes sold (billion)	Cigarettes sold (billion)	Cigarettes sold (billion)	Cigarettes sold (billion)
30 2010 26	81 2010 73	67 2010 61	48 2010 48
Volume growth	Volume growth	Volume growth	Volume growth
+14% 2010 +2%	+11% 2010 +8%	+10% 2010 -1%	0% 2010 +18%
Number of markets	Number of markets	Number of markets	Number of markets
60+ 2010 60+	110+ 2010 100+	75+ 2010 70+	120+ 2010 120+

Productivity

Productivity continues to be an important part of our strategy, providing the capabilities and resources we need to support investment in our brands to grow share in our key markets

Our globally-integrated supply chain is evolving as efficiency and effectiveness improves, and we are focused on making our operations flexible, agile and truly consumer-centric. A supply chain with the scale we enjoy must also be capable of responding rapidly to changes and have the ability to roll out innovative products better than competitors

This is a key aspect of our Group strategy and we will continue to leverage our supply chain to further support the growth of the business

Productivity savings

Cost management is a focus across the business, as is improving our marketing efficiency and capital effectiveness

This includes reducing unnecessary complexity to save costs, and utilising our cash and assets more effectively

Productivity savings from the supply chain, including indirect material procurement and overhead savings, helped improve our operating margin by 230 basis points in 2011. We are confident that we can continue to deliver efficiencies for the foreseeable future and hit growth in operating margin of 50-100 basis points per annum

Optimising resource allocation

Our integrated supply chain continues to help deliver growth. Innovations were successfully rolled out in a number of markets across the globe, with notable successes such as Convertibles

Transparency of demand and supply at a global level through sales and operations planning continues to improve results. Engagement, system and process improvements are delivering better and faster decision making and resource allocation

As a result, in 2011 we were able to continue to optimise our manufacturing footprint. Over the last 10 years we have reduced the number of cigarette factories from 87 to 46 including acquisitions. In 2011, we stopped manufacturing at Cirebon in Indonesia and announced the future closure of our Bremen factory in Germany and the downsizing of others

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

This has also allowed us to roll out innovations faster and implement machine technology standards – improving our sourcing flexibility, contingency planning and capital effectiveness

Procurement joint venture

Our procurement joint venture with other multi-national companies continues to exceed expectations as it leverages scale and builds expertise in indirect spend. We expect further benefits as we expand its geographic reach and include new categories

Leaf supply chain

Our leaf supply chain is the most vertically integrated in the industry and continues to provide a competitive advantage. Through our proven expertise in leaf we are in a strong position to address new consumer needs and the effects of product-based regulation

Our leaf footprint ensures sustainability of supply and guarantees access to quality sources of leaf, it also gives us the ability to manage short-term variations in pricing driven by external commodity pricing pressures

Business continuity

Managing risk and having in place contingency sourcing plans continue to be a key part of our philosophy. The strength of our above-market operating model was again tested in 2011 with the unfortunate events in Japan, but we successfully satisfied consumer demand

Strategic review continued

Winning organisation

We can only maintain a strong workforce if we nurture and develop our people. We value our employees' diverse perspectives and encourage them to perform to their best.

Training and development

A range of training programmes was rolled out to all of our companies in 2011 when we launched a new online training and development system. This provides our people with access to a suite of e-learning applications and gives our companies a clearer view of the training and capability gaps in their operations.

Recruitment

Ensuring clear succession plans are in place for every senior role remains our long-term objective. We continue to build robust succession plans at all levels and aim to recruit individuals who will help strengthen our core capabilities and our culture.

Diversity and equality

We are dedicated to providing equal opportunities to each employee. We do not discriminate when making decisions on hiring, promotion or retirement on the grounds of race, colour, gender, age, social class, religion, smoking habits, sexual orientation, politics or disability – subject to the inherent requirements of the role to be performed.

We are committed to providing training and development for people with disabilities, tailored where appropriate. If a British American Tobacco employee becomes disabled while in our employment, we will do our best to retain them and make appropriate adjustments and provisions.

Our focus on diversity includes having greater representation across our senior management from both genders and across different geographic regions.

We continue to support the career development of our female managers, with the aim of increasing the proportion of women in senior management roles. This includes drawing up development plans for our senior women and monitoring progress against them, assigning mentors and encouraging recruitment consultancies to draw up gender-balanced candidate shortlists when we recruit externally.

Employee engagement

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

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

Our Sharesave Scheme, our Partnership Share Scheme and our Share Reward Scheme are open to all UK employees.

Employee opinion survey

Our 'Your Voice' employee opinion survey is conducted every two years and benchmarks our performance against a comparator group of Fast Moving Consumer Goods (FMCG) companies. Our most recent survey was conducted in 2010, with 90 per cent of employees participating.

In all 11 categories, employee opinion of British American Tobacco was more positive than the benchmark for businesses in the FMCG sector. We either maintained or improved on our 2008 scores in eight of the 11 categories.

56,265

Number of people we employ around the globe

Responsibility

Responsibility is integral to everything we do and is especially important to a business such as ours where our products pose real risks to health. Our determination to act responsibly spans the whole business, from our commitment to addressing the issues of child labour and working with farmers, to looking at how we can help to reduce the harm from our products and lessen our environmental impact.

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 also support regulation that maintains a balance between consumer preferences and the interests of society, while also enabling our business to continue to compete commercially.

Harm reduction

As a manufacturer of tobacco products we have a responsibility to pursue ways in which we might help to reduce the health risks of our products. For more information on our approach to harm reduction, see page 19.

In 2011, we made progress in our work on developing laboratory models of disease and we also set up a new research group, Predictive and Experimental Toxicology. This group is focused on developing the science that will enable us to evaluate which smoke toxicants are the most significant in the development of various smoking-related diseases.

We made good progress this year in increasing our understanding of how and where smoke particles are deposited in the respiratory system. We have also reinvigorated our biotechnology research.

We believe tobacco product regulation should be underpinned by sound scientific evidence and developed through transparent and accountable consultation with all relevant stakeholders. As such, in 2011 our Chief Scientific Officer sat on the expert panel of a workshop held by the US Food and Drug Administration on developing scientific standards for the evaluation of modified risk tobacco products.

Research & development

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

Our principal R&D facilities are located in Southampton and Cambridge in the UK and at Cachoeirinha in Brazil. In 2011, investment in Group R&D, including Marketing Futures and Nicoventures, was £166 million, compared to £164 million in 2010.

Responsible marketing

We apply a consistently responsible approach to marketing across the Group by requiring our companies to follow our International Marketing Standards (IMS) wherever local law is less stringent. Our IMS state that our marketing should be targeted at adult tobacco consumers and not undermine their understanding of the health risks.

£166m

Group R&D expenditure
in 2011

Our companies' adherence to IMS is monitored through self-assessments and internal company audits. We have now introduced additional IMS-specific audits in selected markets. In 2011, 21 incidents of non-adherence were identified, but we believe these to be isolated incidents and actions have been taken to address them.

In Indonesia, we are engaging with the Indonesian Government on implementing stricter regulations to ensure a level playing field and hope to bring about an industry consensus.

Strategic review continued

Environmental performance

We monitor and reduce our direct impact on the environment by making our operations more efficient. We also address our indirect effects by choosing suppliers with strong environmental credentials and encouraging our existing suppliers to improve their environmental performance.

We have set targets for our key environmental issues, including energy consumption, greenhouse gas emissions, water use and waste and we met these in 2011 (see page 25).

In 2011, we began work to develop new targets for our energy, water and waste measures, as well as five-year milestones to monitor progress towards our 2030 and 2050 carbon dioxide equivalent (CO₂e) targets.

Agronomy support

We have around 1,000 leaf managers and technicians worldwide who provide agronomy support to all our directly contracted tobacco farmers. They also engage with farming communities in all of our tobacco growing locations. Our global agronomy centre is at the heart of this engagement.

Working with our contracted farmers in this way helps make their farms viable and efficient, which protects the security and quality of our tobacco leaf supply. Our agronomy support covers all areas of agricultural practice, not just tobacco farming, so it also helps farmers improve the quality and yields of food crops, making them more self-sufficient.

Tackling child labour

Child labour is an important human rights issue for any industry with an agricultural supply chain and the tobacco industry is no exception. We have had a Group-wide Child Labour Policy since 2000, and it is a key element of our Social Responsibility in Tobacco Production (SRTP) programme. We were also one of the founding members of the Eliminating Child Labour in Tobacco Growing (ECLT) Foundation in 2001. We continue to play an active role in the ECLT Foundation along with others in the industry, trades unions and the International Labour Organisation.

Biodiversity

Our Group Biodiversity Statement states our aim to embed biodiversity conservation across our business. Since 2001, we have worked with three NGOs in the British American Tobacco Biodiversity Partnership: Fauna & Flora International, the Tropical Biology Association and Earthwatch Institute. The Partnership seeks to address some of the challenging issues surrounding the conservation and management of biodiversity within agricultural landscapes and the ecosystems on which we depend.

External recognition

We have built a strong reputation for sustainability and are recognised as leaders in our industry.

In 2011, we were included in both the Dow Jones Sustainability World Index (DJSI World) and the Dow Jones Sustainability Europe Index (DJSI Europe) and we also received a gold rating in the 2011 Business in the Community Corporate Responsibility Index.

Corporate social investment

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

Our global CSI expenditure in 2011 was £13.7 million (2010: £15.4 million) as defined by the statutory reporting criteria for charitable donations.

Work environment

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

There were 37 serious injuries in 2011, involving 18 employees and 19 contractors in 21 countries. Seven were fatalities (one employee and six contractors), compared to four in 2010 (three employees and one contractor). Four were the result of assaults, two were from falls from heights and one was the result of a road traffic accident. We greatly regret this loss of life and have made changes to try to make sure accidents like these do not happen again.

We monitor our Lost Workday Case Incident Rate (LWCIR), along with the number of serious injuries and fatalities for both employees and contractors. The Group's LWCIR in 2011 was 0.26, a decrease from the 2010 rate of 0.27. Our total number of lost workday cases also decreased, from 212 in 2010 to 204 in 2011.

In 2011, we implemented our plan to reduce vehicle-related injuries in our Trade Marketing & Distribution teams. Already, we have seen positive results, with an 18 per cent reduction in the teams' vehicle-related lost workday cases and a reduction in fatalities compared to 2010. Group-wide vehicle-related accidents decreased by nearly 19 per cent compared to 2010. Following targeted initiatives to address manual handling accidents, lost workday cases in this area reduced by 53 per cent for the Group.

Our sustainability goals

Sustainable business practice is at the heart of the Group's responsibility strategy. By addressing our social, environmental and economic impacts, we build value for the business, for our shareholders and for other stakeholders.

Our sustainability agenda comprises five goals covering harm reduction, marketplace, environment, supply chain and people and culture. You can read about all our long-term goals and our work in 2011 in these areas in our Sustainability Report 2011 online at www.bat.com/sustainability

Included on the following pages is a brief summary of how we are trying to meet our sustainability goals and achieve a sustainable future through

- working towards reducing the risks from our products,
- supporting regulation based on sound evidence,
- marketing our products responsibly,
- promoting sustainable agriculture,
- investing in our people, and
- working with others

www.bat.com/sustainability

Harm reduction

Our long-term harm reduction goal

We will strive to bring commercially viable, consumer acceptable reduced-risk products to market.

27

Scientific papers submitted for publication in peer-reviewed journals in 2011

The greatest negative impacts from our business are the real and serious health risks of tobacco products. So developing reduced-risk products for those adults who use tobacco is a priority. There are many challenges in this: the science is complex, collaboration is needed between scientists, tobacco companies and regulators, products need to meet consumer expectations, and we need a regulatory framework that supports tobacco harm reduction. We are committed to meeting these challenges.

We are working on three broad product categories: reduced-toxicant combustible tobacco products, low-toxicant smokeless tobacco products, and alternative regulatory-approved nicotine products.

How we are preparing for the future

- Identifying which smoke toxicants pose the greatest health risks and inventing new technologies to reduce them
- Developing a framework of scientific tests to evaluate the likely health impacts of potentially reduced-risk products
- Engaging with regulators, scientists and the public health community to develop the frameworks needed to bring them to market
- Nicoventures is exploring the development of and commercialisation of regulatory-approved nicotine products

Strategic review continued

Marketplace

Our long-term marketplace goal

We will take a lead in upholding high standards of corporate conduct within our marketplace.

73%

Of our companies run youth smoking prevention programmes

Our aim is to grow our market share but we do this responsibly through innovative products and packaging. We believe that regulation should be shaped in collaboration with all stakeholders, including the tobacco industry. With our industry experience and expertise, we can be part of developing regulatory solutions.

The illegal tobacco trade is a widespread problem, made worse by ill-considered regulatory policies and particularly by large and sudden increases in excise tax that destabilise the market. The perpetrators of this trade are criminals, often gangs that also traffic drugs, arms and people, and may have ties to terrorist organisations.

How we are preparing for the future

- Sharing objective evidence to help contribute to the policy debate on regulation, as well as supporting regulation for the development and sale of reduced-risk products
- Updating and strengthening adherence to our International Marketing Standards
- Collaborating with governments and enforcement authorities to help address the illegal tobacco trade and working with our competitors to develop new technologies to stop the unauthorised sale, re-sale or smuggling of tobacco products

Environment

Our long-term environment goal

We will actively address the impacts of our business on the natural environment.

-7.5%

Energy use per million cigarettes equivalent compared to 2010

Addressing the immediate impacts of our business on the environment as well as the likely future pressures involves risk assessments, performance management and investment in efficient technologies. Environmental problems cannot be solved by one company acting alone. They also need flexibility – what works in one part of the world might not in another.

The success of our business now and in the future depends on biodiversity. Biodiversity provides resources like clean water, healthy soils and timber. Business can have a negative impact on biodiversity, as species and communities also depend on these resources.

How we are preparing for the future

- Using risk assessments and stakeholder dialogue to guide our approach to climate change
- Developing strategies to reduce our impacts, focusing on water, energy and biodiversity
- Using biodiversity risk and opportunity assessments to guide our approach to sustainable agriculture
- Working with external stakeholders on areas of common interest, such as the members of our Biodiversity Partnership

Supply chain

Our long-term supply chain goal

We will work for positive social, environmental and economic impacts in our supply chain.

443,480

Tonnes of tobacco leaf purchased by our companies in 2011

Our supply chain sustainability strategy covers our own planning, manufacturing, logistics and trade marketing operations, but the most significant part of it relates to tobacco growing. This is where our greatest environmental impact is but where we have influence, rather than direct control.

We believe effective regulation in this area must cover all agriculture, not just tobacco. We also believe we have an important part to play in developing sustainable agriculture solutions, thanks to our experience and our relationships with over 140,000 contracted farmers in 19 countries.

How we are preparing for the future

- Protecting the long-term security of our tobacco leaf supply by encouraging sustainable agriculture, involving multi-stakeholder partnerships
- Working to help build an objective evidence base on the impact of tobacco growing compared to other crops
- Listening to our Supply Chain Sustainability Stakeholder Panel's guidance and challenge on our supply chain sustainability issues
- Reducing the environmental impact of our own operations and encouraging our suppliers to reduce theirs
- Using our supply chain programmes and partnership projects with suppliers and third parties to protect the human rights of our suppliers, contracted farmers and local communities

People and culture

Our long-term people and culture goal

We will work to ensure we have the right people and culture to meet our goals.

64

Nationalities represented by people working at our global headquarters in the UK

To achieve the goals we set for our business we need a strong workforce – from securing our supply of tobacco leaf to developing reduced-risk products. We can only strengthen our culture and build competitive advantage if we continue to focus on driving high performance, encourage greater productivity and build on the excellence of our talent.

Diversity helps us to understand our stakeholders and to meet their needs. It takes many forms: gender is one aspect, but it is also important to consider nationality and background. We have a number of initiatives to improve gender diversity at senior management levels and we are committed to improving the representation of all nationalities among our senior leaders at our headquarters and in our companies worldwide.

How we are preparing for the future

- Continuing to build robust succession plans
- Establishing clear principles and simple, effective tools to manage performance
- Embracing the diversity of our workforce to encourage creativity and innovation
- Improving our approach to the health, wellbeing and safety of our people
- Streamlining our global practices and eliminating duplication
- Strengthening our core capabilities, our values and our culture

Measuring our performance

We have a wide range of measures and indicators by which the Board assesses performance. To ensure management's focus is aligned with the interest of our shareholders, our KPIs are reflected in our management incentive schemes. Although our other business measures are not directly included in these incentives, we believe they improve the quality of our business and contribute to shareholder value, particularly over the long term.

Shareholder value

Key performance indicators (KPIs)

Total shareholder return – annual %

The Group's strategy is to focus on increasing shareholder value, which is measured using Total Shareholder Return (TSR) compared to the FTSE 100 Index and also to the Fast Moving Consumer Goods (FMCG) peer group. The FMCG comparator group is reviewed annually to ensure that it remains both relevant and representative.

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

Earnings per share

This is our adjusted diluted EPS – the detail of the calculation and the adjustments made are explained in note 7 to the financial statements.

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

+11%

Adjusted diluted EPS growth

Growth

Key performance indicators (KPIs)

Group's share of key subsidiary markets

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

Our target is to continue to grow market share

Global Drive Brand (GDB) volumes

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

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

Business measures

Share growth in key segments

This is our overall share of volume in the Group's Top 40 markets in three key segments: Adult Smokers Under 30 (ASU30), Premium and Fresh Taste.

Our target is to maintain or grow our share of volume in each segment each year on an organic basis

* share figures are rebased annually to reflect market and segment size changes

We reduced our measures used in the assessment of our performance related bonus scheme from six to four in 2011, following shareholder consultation in late 2010 and in early 2011. While we continue to measure both 'net revenue' and 'overheads and productivity savings', we no longer include these as KPIs in that assessment.

Using just the four KPIs of 'Group's share of key subsidiary markets', 'Global Drive Brand volumes', 'adjusted profit from operations' and 'cash flow from operations' provides a simplified, straightforward and transparent set of measures. These KPIs still allow the Company to assess the vitality, sustainability and performance of the business while providing clarity for both shareholders and scheme participants about the required areas of performance.

* share figures are rebased annually to reflect market and segment size changes

Measuring our performance continued

Productivity

Key performance indicators (KPIs)

Adjusted profit from operations

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

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

Cash flow from operations

Cash flow from operations is defined as the net of the operating cash flow and interest paid, tax paid and dividends paid to non-controlling interests, per the alternative cash flow presented on page 37

A specific target is set each year for the cash flow from operations. The target for 2011 was exceeded

Business measures

Operating margin

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

Our target is to increase operating margin by 50-100 basis points per annum

Free cash flow as a percentage of adjusted earnings

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

Our target is to maintain the percentage figure in the mid-80s

Winning organisation

Business measures

'Your Voice' employee opinion survey

We collect views from employees through our 'Your Voice' survey once every two years to help us measure our progress in employee engagement.

Our target is to achieve more positive scores than the other Fast Moving Consumer Goods (FMCG) companies in our comparator benchmark group in all areas. In 2010, scores in all categories were more positive than the FMCG benchmark, and we either maintained or improved on our 2008 score in eight of the 11 categories

Lost Workday Case Incident Rate (LWCIR)

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

Our global aim is to have an LWCIR of not more than 0.2 by the end of 2012. The local target set for all of our companies is zero accidents.

Lost Workday Case Incident Rate (LWCIR)

$LWCIR = \frac{\text{Lost workday cases through injury} \times 200,000}{\text{total hours worked}}$

Responsibility

Business measures

Dow Jones Sustainability Indexes

The Indexes track economic, environmental and social performance of leading companies based on the integration of sustainability into their businesses

Our target is to achieve a higher score than the sector average in a minimum of 14 out of 19 categories. In 2011, we achieved a higher score in all 19 categories

Group energy use

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

Our target is to reduce energy use by 6.7 per cent by 2012 from our 2007 base

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

Waste to landfill

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

Our target is to reduce waste sent to landfill in tonnes per million cigarettes equivalent by 12 per cent by 2012 from our 2007 base

Water use

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

Our target is to reduce water use by 48 per cent by 2012 from our 2002 base

Carbon dioxide equivalent (CO₂e)

CO₂e is largely derived from energy consumption and we track this in tonnes per million cigarettes equivalent

Our target is to reduce Group CO₂e by 50 per cent by 2030 from our 2000 base

Group CO₂e is calculated from the energy used in Group operations, business travel and freight and incineration and landfill

Recycling

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

Our target is to recycle more than 85 per cent of waste generated in each year

Our targets for Group energy use, waste to landfill and water use were all exceeded in 2011, a year ahead of schedule. For more information on these business measures, our performance and targets, see our Sustainability Report 2011 online

Chief Operating Officer's review

A strong Group performance

Against the backdrop of global financial uncertainty, generally lower disposable incomes and political upheaval in some parts of the world, the Group delivered a strong performance in 2011, achieving all the goals set as part of its long-term strategy. Reported revenue grew by over 3 per cent as a result of continued good pricing momentum and stable volumes. At constant rates of exchange, revenue was up 4 per cent, while on an organic basis at constant rates of exchange, it increased by 7 per cent.

The reported profit from operations was 9 per cent higher at £4,721 million with an 11 per cent increase in adjusted profit from operations, as explained on page 34. At constant rates of exchange, the adjusted profit increase was 10 per cent. All the regions contributed to this good profit result. Organic adjusted Group profit from operations, at constant rates of exchange, also increased by 10 per cent.

Group volumes from subsidiaries were 705 billion, down by 3 billion or 0.4 per cent. Organic volumes were also 0.4 per cent lower. The Group again grew overall market share in its Top 40 markets.

The four Global Drive Brands achieved excellent overall volume growth of 9 per cent following the successful launches of innovations, resulting in the continued improvement in market share. Dunhill volumes increased slightly as strong growth in Brazil, Romania and the GCC, and good performances by Malaysia and Russia, were offset by a decline in South Korea which was affected by competitor pricing. Excluding the volumes in South Korea, Dunhill volumes were up 8 per cent. Kent was 10 per cent higher with increased volumes in Romania, Ukraine, Russia, Egypt and Japan.

Lucky Strike increased volumes by 14 per cent with growth in Spain, Germany, France, Italy, Japan, Chile and Brazil. Pall Mall volumes rose by 11 per cent with strong growth in Pakistan, Turkey, Russia and Canada, partially offset by lower volumes in Mexico and Spain.

The Group announced at the end of 2010 that as part of the plans to reduce complexity, drive efficiency in management structures and achieve a better balance in the scale of our regions, it had decided to reduce the management structure from five to four regions from 1 January 2011. Markets which comprised the Eastern Europe region, were merged into the Africa and Middle East region and the Western Europe region. Russia, Ukraine, Moldova, Belarus, Caucasus and Central Asia form part of the new Eastern Europe, Middle East and Africa region (EEMEA), while Romania, Bulgaria, Serbia, Montenegro, Albania and Kosovo form part of the Western Europe region. The 2010 information has been reallocated on the basis of the new regional structure.

John Daly
Chief Operating Officer

2011 highlights

- **Group organic revenue growth of 7 per cent at constant rates**
- **Volumes down 0.4 per cent to 705 billion**
- **Overall market share growth in the Top 40 Group markets**
- **Global Drive Brand volumes up 9 per cent**
- **Adjusted profit from operations at constant rates of exchange up 10 per cent to £5,486 million**

Operations by region

Asia-Pacific	Americas	Western Europe	Eastern Europe, Middle East and Africa (EEMEA)
Share of Group revenue	Share of Group revenue	Share of Group revenue	Share of Group revenue
28%	23%	23%	26%
2010 25%	2010 24%	2010 25%	2010 26%
Revenue (£m)	Revenue (£m)	Revenue (£m)	Revenue (£m)
4,251	3,558	3,600	3,990
2010 3,759	2010 3,498	2010 3,695	2010 3,931
Adjusted profit ⁽¹⁾ (£m)	Adjusted profit ⁽¹⁾ (£m)	Adjusted profit ⁽¹⁾ (£m)	Adjusted profit ⁽¹⁾ (£m)
1,539	1,441	1,228	1,311
2010 1,332	2010 1,382	2010 1,103	2010 1,167
Volume (bn)	Volume (bn)	Volume (bn)	Volume (bn)
191	143	135	236
2010 188	2010 149	2010 136	2010 235

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

Regional review

Asia-Pacific

Share of Group revenue

28%

2010 25%

Adjusted profit from operations (£m)

1,539

2010 1,332

David Fell
Director, Asia-Pacific

Profit was up £207 million to £1,539 million as a result of strong performances in Japan, Bangladesh and Taiwan and favourable exchange rates in Australia, Japan and New Zealand. At constant rates of exchange, profit increased by £148 million or 11 per cent. Volumes at 191 billion were up 2 per cent, with increases in Japan, Pakistan and Indonesia partially offset by lower volumes in South Korea, Australia and New Zealand.

In Australia, the steep excise increase during 2010 impacted industry volumes. Profit was up as a result of cost saving initiatives, favourable exchange movements and higher pricing, partially offset by additional costs associated with the campaign against plain packaging. Market share was slightly lower although Pall Mall performed well. In New Zealand, volumes decreased following an ad-hoc excise increase in January 2011. Profit was lower as pricing and favourable exchange rate movements were more than offset by lower volumes.

Market share grew in Malaysia, driven by the strong performances of Dunhill and Peter Stuyvesant, although total industry volumes were lower following the excised price increases in 2010. Profit was higher, mainly as a result of exchange rate movements.

In Japan, industry volumes were down sharply following a significant excise increase in October 2010. However, as a result of the disruption to domestic production following the tragic events in March 2011, the Group delivered an exceptionally strong growth in profit and volumes for the year, with underlying market share higher.

In Vietnam, volumes and market share grew but profit was adversely impacted by high inflation and an exchange rate devaluation, partially offset by higher pricing and cost saving initiatives.

Profit in South Korea was impacted by competitor pricing and significant marketing investment, following a price increase by the Group's business at the end of April 2011, the first in the industry in over six years. Lower volumes also led to a reduction in market share.

In Taiwan, significant profit growth was driven by higher volumes and improved industry pricing. Good performances by Dunhill and Pall Mall achieved higher market share.

Volume growth in Pakistan led to a strong increase in market share as Pall Mall performed well, more than doubling its volumes. Profit was stable, adversely impacted by higher special excise duties, high inflation and severe price competition in the low-priced segment. In Bangladesh, both market share and volumes grew due to the strong performance of Benson & Hedges. Profit increased as a result of higher volumes, price increases and tight control of costs.

Profit grew in Indonesia following higher volumes, price increases and synergies resulting from the integration of the business units during 2010 which were partially offset by higher clove prices and marketing investment. Market share was marginally lower as the growth of the mild kretek brands was more than offset by the rationalisation of the brand portfolio.

Americas

Share of Group revenue

23%

2010 24%

Adjusted profit from operations (£m)

1,441

2010 1,382

Jack Bowles Director, Americas

Profit rose by £59 million to £1,441 million, mainly attributable to a strong performance from Brazil, Venezuela and Mexico and an improved product mix across the region. At constant rates of exchange, profit rose by £58 million or 4 per cent. Volumes were down 4 per cent at 143 billion, mainly as a result of decreases in Mexico, Brazil, Chile and Venezuela.

In Brazil, strong profit growth was driven by an improved product mix and higher pricing. Market share and volumes were slightly lower due to the growth of local duty evaded product. However, volume, share in the premium segment and share compared to international competitors continued to grow as a result of the solid performances of Lucky Strike, Dunhill and Free.

Industry volumes were lower in Canada as a result of increased illicit trade, with aggressive price competition in the low-priced segment fuelling down-trading. These factors adversely impacted volumes, market share and profit, although du Maurier and Vogue maintained their share in the premium segment and John Player Standard remained the number one brand in Canada.

In Mexico, industry volumes declined sharply as a result of excise-led price increases at the beginning of 2011, as well as increased purchases by the trade during December 2010 in anticipation of the price increase. Market share was marginally down on last year, while profit was higher, benefiting from increased pricing and lower costs.

In Argentina, market share was lower despite the growth of Lucky Strike and the successful launch of Dunhill. Marketing investment was higher with the launch of new brands and competitors' pricing activities, impacting profitability. Lucky Strike performed well in Chile, and the very strong market share was maintained. Volumes were lower, following the steep excise-driven price increases, adversely impacting profit.

Profit in Venezuela grew strongly as a result of higher pricing, partially offset by increased costs and lower volumes, although market share rose. Volumes were down due to industry declines and growth in illicit product. The Group acquired Protabaco, the second largest cigarette company in Colombia, on 11 October 2011. Protabaco and British American Tobacco Colombia are operating from January 2012 as one entity with a market share of almost 50 per cent.

Regional review continued

Western Europe

Share of Group revenue

23%

2010 25%

Adjusted profit from operations (£m)

1,228

2010 1,103

Mark Cobben

Director, Western Europe

Profit in Western Europe increased by £125 million to £1,228 million, mainly as a result of strong performances in Germany, Switzerland, Italy, France and Romania, partially offset by declines in Spain, the Netherlands and Greece. At constant rates of exchange, profit increased by £101 million or 9 per cent. Regional volumes were marginally lower at 135 billion as a result of declines in Germany, Switzerland, Italy, Greece and Spain, partially offset by an increase in Romania.

In Italy, volumes and market share were slightly lower although the Global Drive Brands performed well. Good profit growth was the result of the improved product mix, price increases and lower costs, partially offset by the effect of the volume decline.

Profit increased in Germany as a result of higher pricing and lower costs. The higher organic market share was driven by excellent performances by Pall Mall and Lucky Strike although volumes decreased.

In France, volumes were higher and market share increased which, together with improved pricing and lower product costs, led to an increase in profit. Lucky Strike and Vogue performed well.

Market share in Spain was up strongly, driven by Pall Mall and Lucky Strike. Industry volumes were lower as a result of the tough economic conditions, unemployment and an excise-driven price increase at the end of 2010.

Profit was impacted by a price war in the middle of the year and lower volumes.

Profit in Switzerland grew strongly as a result of reduced costs and increased pricing. Volumes were lower but market share grew through the performance of Kent and Pall Mall. Volumes and profit in Belgium and the Netherlands were lower but market share increased in Belgium with Pall Mall and Lucky Strike performing well.

In Romania, excellent increases in profit and volumes were achieved as the industry benefited from the significant reduction in the level of illicit trade following the strong action taken by the Government. Market share was higher, led by Dunhill, Kent and Vogue.

In Poland, despite an industry volume decline, profit, volumes and market share increased with the growth of Viceroy and Vogue. Market share in Greece was higher and Peter Stuyvesant achieved leadership in the low-priced segment. The partial absorption of excise increases by the industry over the last two years contributed to a drop in profit. In the United Kingdom, Pall Mall performed well, resulting in market share growth, which, coupled with price increases, cost management and higher volumes, led to higher profit.

Profit was maintained in Denmark where industry volumes were adversely affected by the impact of two significant excise-driven price increases. Market share was recovering by the year end. In Sweden, profit improved as a result of lower costs, improved pricing and volumes. Market share was also higher.

Eastern Europe, Middle East and Africa (EEMEA)

Share of Group revenue

26%

2010 26%

Adjusted profit from operations (£m)

1,311

2010 1,167

Andrew Gray
 Director, Eastern Europe,
 Middle East and Africa

Profit in the region increased by £144 million to £1,311 million. This was principally due to stable volumes and price increases, partly offset by the adverse impact of exchange rate movements. At constant rates of exchange, profit increased by £195 million or 17 per cent. Volumes at 236 billion were marginally higher than last year with the increases in Egypt, GCC and Nigeria partially offset by the decline in Turkey.

In Russia, market share grew, driven by Kent, supported by Dunhill, Pall Mall and Vogue. Total volumes were in line with last year. Strong profit growth was the result of price increases, an improved product mix and lower costs.

Market share in Ukraine was higher as volumes increased in a declining total market, resulting in an increase in profit. Volumes, profit and market share improved in Kazakhstan due to the strong performance of Pall Mall.

In Turkey, the 2010 excise-driven contraction of the market continued with the government announcing an unexpected excise rise in October 2011, with a further increase from January 2013. This, coupled with an increase in illicit trade, resulted in a steep drop in volumes. Market share declined as a result of competitor pricing activities. Kent and Pall Mall grew strongly and

Lucky Strike was launched, partially offsetting the volume losses of tail brands. Profit reduced despite the improved product mix and significant savings initiatives.

In the GCC markets, volumes and market share increased and profit grew strongly, mainly due to Dunhill's excellent performance in all the markets. In Egypt, volumes and market share continued to grow strongly despite the political instability and a significant excise increase in June. Profit was impacted by the absorption by manufacturers of some of the excise increases of 2010 and 2011. Rothmans expanded its leadership position among our international brands.

In Nigeria, volumes were up and market share continued to grow. Premium brands posted impressive rises with Dunhill, Benson & Hedges and Rothmans the main contributors. The improved product mix and higher volumes led to a strong increase in profit. Growth in market share was primarily driven by marketing investment. Improved government control saw a reduction in illicit trade.

In South Africa, market share strengthened due to the good performance of the portfolio. There was a significant increase in the incidence of illicit trade and down-trading to the low-priced segment. As a result, profit was in line with last year.

The Group continued its investment in new markets, with the launch of Dunhill in Morocco after an import and distribution licence was approved, while it continued to build the business in Algeria.

Financial review

Another year of strong returns

Profit from operations

The reported Group revenue at £15,399 million grew by 3 per cent and profit from operations at £4,721 million grew by 9 per cent

The growth in Group revenue, at constant rates of exchange, was up 4 per cent to £15,462 million

In order to better understand the underlying performance of the business, it is necessary to adjust for a number of items relating, for example, to restructuring costs and one-off charges and provisions. We call the underlying profit after adjusting for these items, adjusted profit. These adjustments are described further below

Adjusted profit from operations was £5,519 million, up 11 per cent from £4,984 million in 2010. Adjusted profit from operations translated at constant rates of exchange was up 10 per cent to £5,486 million

Organic growth

A number of transactions impacted revenue and operating profit in 2011 and 2010. The impact of these are removed in order to calculate organic growth

For 2011, revenue growth was slightly enhanced by the acquisition of Productora Tabacalera de Colombia, S A S (Protabaco), which was completed on 11 October. The Group's organic revenue growth was also affected by the sale of its Belgium distribution business, Lyfra NV, its withdrawal from distributing phone cards in Brazil and products in Norway and the termination of the Gauloises licence agreement applicable to Germany. Adjusting for these items, organic revenue would have been up 7 per cent to £15,453 million at constant rates of exchange. On the same basis, adjusted profit from operations grew organically by 10 per cent to £5,487 million

Ben Stevens

Finance Director and
Chief Information Officer

2011 highlights

- Group organic revenue grew by 7 per cent at constant rates of exchange
- Adjusted profit from operations increased by 11 per cent
- Adjusted diluted earnings per share rose by 11 per cent to 194.6p per share
- Dividends for 2011 up by 11 per cent to 126.5p per share
- Strong free cash flow of £3,326 million equal to 86 per cent of adjusted earnings
- Share buy-back to a value of £1.25 billion announced for 2012

Percentage increases in revenue and in profit from operations

	Revenue growth	Profit growth
As reported	+3%	+9%
Adjusted		+11%
Adjusted at constant rates	+4%	+10%
Adjusted organic at constant rates	+7%	+10%

Analysis of revenue and profit from operations

Revenue	2011					2010		
	Reported revenue £m	Impact of exchange £m	Revenue at CC ⁽¹⁾ £m	Organic adjustments ⁽³⁾ £m	Organic revenue at CC ⁽¹⁾ £m	Reported revenue £m	Organic adjustments ⁽³⁾ £m	Organic revenue £m
Asia-Pacific	4,251	(101)	4,150		4,150	3,759		3,759
Americas	3,558	16	3,574	(9)	3,565	3,498	(134)	3,364
Western Europe	3,600	(68)	3,532		3,532	3,695	(282)	3,413
EEMEA	3,990	216	4,206		4,206	3,931		3,931
Total	15,399	63	15,462	(9)	15,453	14,883	(416)	14,467

Profit from operations

	2011							2010		
	Profit ⁽²⁾ £m	Adjusting items £m	Adjusted profit ⁽²⁾ £m	Impact of exchange £m	Adjusted profit ⁽²⁾ at CC ⁽¹⁾ £m	Organic adjustments ⁽³⁾ £m	Organic adjusted profit ⁽²⁾ at CC ⁽¹⁾ £m	Adjusted profit ⁽²⁾ £m	Organic adjustments ⁽³⁾ £m	Organic adjusted profit ⁽²⁾ £m
Asia-Pacific	1,481	58	1,539	(59)	1,480		1,480	1,332		1,332
Americas	1,426	15	1,441	(1)	1,440	1	1,441	1,382	(3)	1,379
Western Europe	1,075	153	1,228	(24)	1,204		1,204	1,103	(6)	1,097
EEMEA	1,013	298	1,311	51	1,362		1,362	1,167		1,167
	4,995	524	5,519	(33)	5,486	1	5,487	4,984	(9)	4,975
Fox River ⁽⁴⁾	(274)	274								
Total	4,721	798	5,519	(33)	5,486	1	5,487	4,984	(9)	4,975

Notes

(1) CC Constant currencies

(2) Profit. Profit from operations

(3) Organic adjustments. Mergers and acquisitions and discontinued activities – adjustments are made to the 2010 and 2011 numbers, based on the 2011 Group position

(4) The Fox River provision made in 2011, (see note 3(h) to the financial statements) has not been allocated to a segment or segments as it relates to a 1998 settlement agreement. It is presented separately from the segmental reporting which is used to evaluate segment performance and to allocate resources

Financial review continued

Operating margin

The Group continues to improve its operating margin by addressing the cost base through factory rationalisation, systems standardisation and productivity savings. In 2011, adjusted profit from operations, as a percentage of net revenue, improved to 35.8 per cent compared to 33.5 per cent in 2010. More details of the Group's adjusted operating performance can be found in the regional review.

Adjusting items

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.

During 2011, the Group continued to incur costs which do not relate to the day-to-day operations of the business.

Restructuring costs include a review of the Group's manufacturing operations, organisational structure and systems and software used. During 2011, we also impaired the remaining goodwill relating to the acquisition of Tekel in Turkey, by £273 million. The total costs of these actions, together with other costs, including integrating acquired businesses into existing operations and the provision in respect of Fox River, were £798 million in 2011, compared to £666 million for 2010.

As explained more fully in the contingent liabilities note 30 to the financial statements, the Group made a provision of £274 million for a potential claim under a 1998 settlement agreement entered into by a subsidiary in respect of the clean up of sediments in the lower Fox River in Wisconsin.

Restructuring and integration costs in 2011 principally relate to the continuation of factory closure and downsizing activities in Denmark and Australia respectively, a voluntary separation scheme and closure of the printing unit in Argentina, the closure of the Jawornik factory in Poland, the Lecce factory in Italy and Tire factory in Turkey. The costs also cover the social plan and other closure activities relating to the Bremen factory closure in Germany, integration of Productora Tabacalera de Colombia, S A S (Protabaco) into existing

operations, as well as other restructuring initiatives directly related to improving the efficiency and effectiveness of the Group as a globally integrated enterprise. In addition, they also include separation packages in respect of permanent headcount reductions in the Group.

The £311 million charge for restructuring and integration costs in 2010 arose principally in respect of the continuation of factory closure and downsizing activities and the continued integration of Skandinavisk Tobakskompagni (ST), Tekel and Bentoel into existing operations, as well as some other activities to reduce the overheads of the Group.

Restructuring and integration costs in 2010 also included a payment of US\$21 million to Reynolds American relating to the early termination of a contract manufacturing agreement.

The acquisitions of Bentoel, Tekel, ST and Protabaco resulted in the capitalisation of trademarks which are amortised over their expected useful lives, which do not exceed 20 years. The 2011 amortisation charge of £58 million, compared to £62 million in 2010, is included in depreciation, amortisation and impairment costs in the profit from operations.

The balance of goodwill remaining in respect of the Tekel acquisition in Turkey in 2008 (£273 million) was impaired during 2011. Although cost saving initiatives in the acquisition plan of Tekel have been delivered successfully, the impairment charges arose from the continued pricing competition, significant excise increases during 2010 and further increases announced in October 2011, resulting in the significant growth of illicit trade and a loss of volumes. Turkey remains an important strategic market for the Group.

Net finance costs

Net finance costs at £460 million were £20 million lower than last year, reflecting the strong cash generation of the business.

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 £120 million to £670 million, after net adjusting income of £11 million (2010 £72 million charge)

In 2011, the Group's share of the adjusted post-tax results of associates increased by 6 per cent to £659 million (2010 £622 million), or 11 per cent at constant rates

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

Profit before tax

Profit before tax was up £543 million at £4,931 million, reflecting the higher profit from operations, lower net finance costs and the increased contribution from associates

Effective tax rate

The tax rates in the income statement of 31.6 per cent in 2011 and 28.4 per cent in 2010 are affected by the inclusion of the share of associates' post-tax profit in the Group's pre-tax results and by adjusting items

The underlying tax rate for subsidiaries reflected in the adjusted earnings per share below was 31.2 per cent in 2011 and 30.2 per cent in 2010. The increase is the result of a change in the mix of profits

Earnings per share

Basic earnings per share for 2011 were 157.1p, up 8 per cent (2010 145.2p). With the distortions that adjusting items can cause in profit, as well as the potential dilutive effect of employee share schemes, earnings per share are best viewed on the basis of adjusted diluted earnings per share. The calculation of this measure is explained in note 7 of the financial statements

On this basis, the adjusted diluted earnings per share were 194.6p, an 11 per cent increase over 2010, mainly as a result of the strong operating performance

Dividends

The Group's policy is to pay dividends of 65 per cent 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

Dividends are declared and payable in sterling except for those shareholders on the branch register in South Africa, whose dividends are payable in rand. A rate of exchange of £ R = 12.19960 as at 21 February 2012, the closing rate for that day as quoted by Bloomberg, results in an equivalent final dividend of 1078.44464 SA cents per ordinary share

With the recommended final dividend of 88.4p, the total dividends per share for 2011 are 126.5p, up 11 per cent on the prior year. Under IFRS, the recommended final dividend in respect of a year is only provided in the accounts of the following year. Therefore, the 2011 accounts reflect the 2010 final dividend and the 2011 interim dividend amounting to 119.1p (£2,358 million) in total (2010 104.8p – £2,093 million). The table below shows the dividends declared in respect of 2011 and 2010

Dividends declared

	2011		2010	
	Pence per share	£m	Pence per share	£m
Ordinary shares				
Interim	38.1	738	33.2	662
Final	88.4	1,741	81.0	1,620
	126.5	2,479	114.2	2,282

Financial review continued

Treasury operations

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

The Board reviews and agrees the overall treasury policies and procedures, delegating appropriate authority to the Finance Director, the Treasury function and the boards of the central finance companies. The policies include a set of financing principles 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.

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 per cent of centrally managed debt maturing in a single rolling 12 months. As at 31 December 2011, the average centrally managed debt maturity was 7.0 years (2010 7.4 years) and the highest proportion of centrally managed debt maturing in a single rolling 12 month period was 18.3 per cent (2010 12.5 per cent).

The Group continues to maintain investment-grade credit ratings, as at 31 December 2011, the ratings from Moody's and S&P were Baa1 (stable outlook)/BBB+ (positive outlook) (end 2010 Baa1/BBB+). The strength of the ratings has underpinned the 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.

Liquidity

In June 2011, the Group established a US\$2 billion commercial paper programme. It is Group policy that short-term sources of funds (including drawings under both the US\$ programme and the existing Group £1 billion euro commercial paper programme) are backed by undrawn committed lines of credit and cash. At 31 December 2011, £85 million of commercial paper was outstanding (31 December 2010 undrawn).

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

In December 2010, the Group negotiated a new central banking facility of £2 billion with a final maturity date of December 2015. This facility is provided by 22 banks. The existing central banking facility of £1.75 billion, with a final maturity date of March 2012 was cancelled at the same time. The facility was undrawn as at the end of both 2011 and 2010. There were a number of transactions in the capital markets in 2010 to extend the maturity of bonds, to purchase and cancel bonds, and to issue new bonds. Details of these transactions are provided in notes 24 and 25 on the accounts.

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 2011 it is 12.5 times (2010 11.2 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 (as a percentage of long-term sustainable earnings) and share buy-back are decided.

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 £286 million, or 6 per cent, to £5,187 million, reflecting growth in underlying operating performance partially offset by working capital movements. Taking into account outflows relating to taxation, which were £269 million higher than last year due to higher taxable profits and an increase in dividends to non-controlling interests, offset by higher dividends and other appropriations from associates due to the Reynolds share buy-back (£71 million in 2011), the Group's free cash flow was £86 million or 3 per cent higher at £3,326 million.

The ratio of free cash flow per share to adjusted diluted earnings per share was 86 per cent (2010 92 per cent).

Below free cash flow, the principal cash outflows for 2011 comprise the payment of the prior year final dividend and the 2011 interim dividend, which was £265 million higher at £2,358 million, as well as a £755 million outflow due to the resumption of the on-market share buy-back programme in 2011, including transaction costs.

During 2011, the cash outflow from net investing activities of £311 million mainly relates to the £295 million purchase of Protabaco, comprising the purchase price less acquired net cash and cash equivalents. In addition, there was a cash outflow of £10 million for the acquisition of non-controlling interests in Chile and £6 million in respect of the purchase of trademarks. In 2010, proceeds included cash from the disposal of subsidiaries of £12 million which arose from the sale of the Group's Belgium distribution business, Lyfra NV, which was offset by a cash outflow of £12 million arising from the acquisition of non-controlling interests in subsidiaries.

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

Cash flow and net debt movements

	2011 £m	2010 £m
Adjusted profit from operations	5,519	4,984
Depreciation, amortisation and impairment	447	442
Other non-cash items in operating profit	68	59
Profit from operations before depreciation and impairment	6,034	5,485
Increase in working capital	(281)	(61)
Net capital expenditure	(566)	(523)
Gross capital expenditure	(611)	(584)
Sale of fixed assets	45	61
Operating cash flow	5,187	4,901
Net interest paid	(469)	(491)
Tax paid	(1,447)	(1,178)
Dividends paid to non-controlling interests	(275)	(234)
Restructuring costs	(217)	(219)
Dividends and other appropriations from associates	547	461
Free cash flow	3,326	3,240
Dividends paid to shareholders	(2,358)	(2,093)
Share buy-back (including transaction costs)	(755)	
Net investment activities	(311)	
Purchases of subsidiaries, non-controlling interests and trademarks	(311)	(12)
Disposal of subsidiaries		12
Net flow from share schemes and other	(93)	(77)
Net cash (outflow)/inflow	(191)	1,070
External movements on net debt		
Exchange rate effects*	123	(41)
Net debt disposed		11
Change in accrued interest and other	(19)	(39)
Change in net debt	(87)	1,001
Opening net debt	(7,841)	(8,842)
Closing net debt	(7,928)	(7,841)

* Including movements in respect of debt related derivatives

Financial review continued

These flows resulted in net cash outflows of £191 million (2010 £1,070 million inflow) After taking account of other changes, especially exchange rate movements, total net debt was £87 million higher at £7,928 million at 31 December 2011 (2010 £7,841 million)

Retirement benefit schemes

The Group's subsidiaries operate around 175 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 £5,675 million (2010 £5,365 million), while unfunded scheme liabilities amounted to £346 million (2010 £337 million). The schemes assets increased from £5,134 million in 2010 to £5,200 million in 2011.

After accounting for minimum funding obligations of £2 million (2010 £29 million) and excluding unrecognised scheme surpluses of £75 million (2010 £51 million), the overall net liability for all pension and healthcare schemes in Group subsidiaries amounted to £898 million at the end of 2011, up from £648 million at the end of 2010.

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

Changes in the Group

On 11 October 2011, the Group completed the transaction to acquire 100 per cent of the privately owned Productora Tabacalera de Colombia, S.A.S. (Protobacco), for US\$461 million. The business has been integrated with the existing British American Tobacco business and from 1 January 2012, it is operating as one business.

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:

	2011 £m	2010 £m
Net debt due within one year		
Borrowings	(1,766)	(1,334)
Related derivatives	5	(29)
Cash and cash equivalents	2,194	2,329
Current available-for-sale investments	57	58
	490	1,024
Net debt due beyond one year		
Borrowings	(8,510)	(8,916)
Related derivatives	92	51
	(8,418)	(8,865)
Total net debt	(7,928)	(7,841)

In 2010, the Group sold its Belgium distribution business, Lyfra NV, withdrew from distributing phone cards in Brazil, and its Gauloises licence agreement applicable to Germany was terminated.

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

Share buy-back programme

The Board approved the resumption of the on-market share buy-back programme in 2011 with a value of up to £750 million, excluding costs. During 2011, 28 million shares were bought at a value of £750 million, excluding transaction costs (2010 £nil). A continuation of the share buy-back to a value of £1.25 billion has been agreed and will resume after publication of the preliminary results.

Non-GAAP measures

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

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

Management reviews current and prior year segmental adjusted profit from operations of subsidiaries and adjusted post-tax results of associates and joint ventures at constant rates of exchange. This allows comparison of the Group's results had they been translated at last year's average rate of exchange. Other than in exceptional circumstances, this does not adjust for the normal transactional gains and losses in operations which are generated by exchange movements.

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. The Group also provides 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 plc on the main board of the JSE Limited (JSE) in South Africa, the Group is required to present headline earnings per share.

Accounting developments

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

The Group has not adopted any new and amended IFRSs or IFRIC interpretations that have had any significant effect on reported profit or equity or on the disclosures in the financial statements in 2011. The next few years, however, are likely to see more changes in the financial statements given the aims of standard setters and regulators.

Going concern

Given the Group's history of growth in profit from operations, the high cash conversion rate from profit into cash, the access to the £2 billion revolving credit facility which is used only as a back stop and the spread of banks providing the facilities, the Group remains confident in its ability to access the debt capital markets.

This, together with the maturity profile of debt, spread over a long period with only limited redemptions scheduled for 2012, provides confidence that the Group has sufficient working capital for the foreseeable future.

After reviewing the Group's budget, plans and refinancing arrangements, the Directors consider that the Group has adequate resources to continue operating for the foreseeable future. The financial statements have therefore been prepared on a going concern basis. See the corporate governance statement for full details.

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	
	2011	2010	2011	2010
US dollar	1 604	1 546	1 554	1 566
Canadian dollar	1 586	1 592	1 583	1 556
Euro	1 153	1 166	1 197	1 167
South African rand	11 632	11 300	12 547	10 358
Brazilian real	2 683	2 719	2 899	2 599
Australian dollar	1 554	1 682	1 516	1 527
Russian rouble	47 116	46 945	49 922	47 795
Japanese yen	127 826	135 518	119 572	126 982

Key Group risk factors

This section identifies the main risk factors that may affect the British American Tobacco Group.

The following tables provide a brief description of the key risks to which the Group's operations are exposed and identify, in each case, their potential impact on the Group and the principal activities in place to manage the risk. Each risk is considered in the context of the Group strategy by identifying the principal strategic element to which it relates, although other elements may also be relevant. The Group strategy is discussed in detail in the preceding pages of this business review.

It is not the intention to provide an extensive analysis of all risks affecting the Group but rather to identify only those risks and uncertainties which the Directors believe to be the principal ones facing the business. Not all of the factors listed are within the control of the Group and other factors besides those listed may affect the performance of its businesses. Some risks may be unknown at present and other risks, currently regarded as immaterial, could turn out to be material in the future.

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

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 and the risk registers and mitigation plans are reviewed on a regular basis. At Group level, specific responsibility for managing each identified risk is allocated to a member of the Management Board. The Group risk register provides the basis for the assessment of the key Group risk factors identified below. It 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 changes in impact and likelihood, and the Audit Committee also spends time focusing on selected key risks in detail.

Developments in the assessment of Group risk

The Board's assessment of the key risks and uncertainties facing the Group has remained broadly unchanged over the past year, particularly with regard to illicit trade, excise and tax and financial risk. However, as a consequence of the Board's continuing reappraisal of Group risks and the activities in place to address them, some risks which have in previous years been considered as key Group risks are no longer assessed as such in terms of their impact and likelihood and so are not addressed in the tables below. They are nevertheless still addressed as Group risks, remain on the Group risk register and continue to be reviewed in accordance with the Group's risk management procedures. This applies, for example, to the loss of confidential information or malicious manipulation of data, which was included in last year's table but is no longer included this year.

Climate change, which has previously been identified as a Group risk, is no longer considered to be a risk factor itself, but is treated as a potential cause of more specific risks, such as the inability to obtain adequate supplies of leaf. It therefore continues to be taken into account in the assessment of Group risk. Non-compliance with environmental, health and safety measures is now assessed as a key Group risk, having been identified as a significant compliance issue facing the Group given the complexity and global nature of its operations and in light of a number of recent incidents involving workplace accidents. In addition, increased focus on the regulatory risks facing the Group has highlighted key areas of risk, now set out separately below. This reflects their importance in the context of the future development of the Group's business and the need to ensure that they are each effectively addressed.

Cautionary statement

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

Illicit trade

Competition from illicit trade

Illicit trade in the form of counterfeit products, smuggled genuine products and locally manufactured products on which applicable taxes are evaded, continues to represent a significant and growing threat to the legitimate tobacco industry. The majority of such illicit products are sold at the bottom end of the market and in contravention of applicable regulatory requirements. Increasing excise rates can encourage more consumers to switch to illegal cheaper tobacco products and provide greater rewards for smugglers. The risk is exacerbated where current economic conditions have resulted in high unemployment and/or reduced disposable incomes. Global volume of illicit trade is currently estimated to be up to 12 per cent of consumption. In the next 10 years, we believe that the problem is likely to increase, driven by the increased regulatory and compliance burden for legitimate manufacturers and fuelled by further significant excise increases.

Principal relevance to Group strategy

Potential impact on **Growth** (organic revenue growth)

Time frame: Long term

Principal potential 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 on Group

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

Principal activities in place to address risk

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

Key Group risk factors continued

Excise and tax

Excise shocks from tax rate increases or structure changes

Tobacco products are subject to substantial excise and sales taxes in most countries in which the Group operates. In many of these countries, taxes are generally increasing, but the rate of increase varies between countries and between different types of tobacco products. A number of significant excise shocks have taken place over the past two years, for example in Romania, Turkey, Malaysia, Mexico and Japan. To date, the Group has been able to balance these shocks with its geographic spread, and it continues to develop effective measures to address the risk.

Principal relevance to Group strategy:

Potential impact on Growth (organic revenue growth)

Time frame Long term

Principal potential causes	Potential impact on Group
<ul style="list-style-type: none"> • Government initiatives to raise revenues • Increases advocated within context of national health policies • Insufficient capacity to engage with stakeholders in meaningful dialogue 	<ul style="list-style-type: none"> • 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
Principal activities in place to address risk	
<ul style="list-style-type: none"> • Requirement for Group companies to have in place formal pricing and excise strategies including contingency plans • Pricing and excise committees at regional, area and individual market levels • Engagement with local tax and customs authorities, where appropriate • Annual management review of brand portfolio, brand health and equity 	

Onerous disputed taxes, interest and penalties

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

Principal relevance to Group strategy:

Potential impact on Productivity (capital effectiveness)

Time frame Short term

Principal potential causes	Potential impact on Group
<ul style="list-style-type: none"> • Non-filing or late filing of tax returns or incorrect filings • Non-payment or late payments of taxes • Unfavourable ruling by tax authorities in disputed areas and aggressive auditing and/or pursuit of tax claims 	<ul style="list-style-type: none"> • 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
Principal activities in place to address risk	
<ul style="list-style-type: none"> • Tax committees • Specialist resources available internally to provide advice and guidance and external advice sought where appropriate • Engagement with tax authorities at Group, regional and individual market level 	

Financial

The Group's underlying operations give rise to certain financial risks. The principal risks in this regard, and the controls in place to address them, are identified below and further details on the Group's financial management and treasury operations can be found within the financial review.

Management of cost base

The Group continues to implement measures to reduce its overall cost base. There is a risk that targeted reductions will fail to be achieved and/or that productivity programmes do not achieve their objectives.

Principal relevance to Group strategy

Potential impact on Productivity (cost management)

Time frame: Short term

Principal potential causes

- Insufficient resources devoted to productivity programmes due to other priorities
- Low prioritisation or resistance to change

Potential impact on Group

- Inability to manage cost savings leads to lower profits and reduced funds for investment in long-term growth
- Reduced shareholder confidence

Principal activities in place to address risk

- Targeted improvements in operating margin through factory rationalisation, systems standardisation and productivity savings
- Development of a formal structure to integrate, drive and orchestrate the delivery of productivity programmes by providing visibility and enabling benefits tracking
- Regular tracking of actual productivity savings and forecast improvements in operating margin and supply chain, overheads and indirect projects
- Aggregation of planned productivity savings in the annual budget

Translational foreign exchange rate exposures

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

Principal relevance to Group strategy

Potential impact on Productivity (capital effectiveness)

Time frame: Short term

Principal potential causes

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

Potential impact on Group

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

Principal activities in place to address risk

- 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

Key Group risk factors continued

Marketplace

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

Inability to obtain required price increases

To the extent that price increases are required to cover cost rises and deliver profit growth, there is a risk that the Group will be unable to achieve these.

Principal relevance to Group strategy

Potential impact on Growth (organic revenue growth)

Time frame: Short term

Principal potential causes	Potential impact on Group
<ul style="list-style-type: none"> Changes in the global economy reduce consumers' disposable income Consumer down-trading Competitors seek volume growth by price discounts or by not taking full price increases 	<ul style="list-style-type: none"> Inability to capture value generated by innovative products Reduction in volumes Profit growth in the short term falls below shareholders' expectations Reduction in funds for investment in long-term growth

Principal activities in place to address risk

- Strong alignment between pricing and brand portfolio
- Regular regional and management reviews of budgeted pricing scenarios
- Pricing and excise committees at regional, area and individual market levels
- Routine brand price trade-off exercises conducted in key markets
- Competitor analysis and price war simulations

Geopolitical tensions

Geopolitical tensions, including terrorism, have the potential to disrupt the Group's business operations.

Principal relevance to Group strategy

Potential impact on Growth (organic revenue growth)

Time frame: Short term

Principal potential causes	Potential impact on Group
<ul style="list-style-type: none"> Regional and/or global conflicts Terrorism and political violence Violent organised crime The implementation of trade sanctions Economic policy changes, including nationalisation of assets and withdrawal from international and bilateral trade agreements 	<ul style="list-style-type: none"> Potential loss of life, loss of assets and disruption to normal business processes Increased costs due to more complex supply chain arrangements and/or the cost of building new facilities or maintaining inefficient facilities Reduced volumes and impact on profits Reputational impact of inability to protect staff and assets from serious harm

Principal activities in place to address risk

- 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

Marketplace (continued)

Non-compliance with environmental, operational and health & safety measures

The Group is subject to environmental, health & safety (EHS) laws and regulations across its operations worldwide. A failure to ensure compliance with such measures could have a significant impact on the Group's business.

Principal relevance to Group strategy

Potential impact on Responsibility (responsible corporate behaviour)

Time frame Short term

Principal potential causes

- Failure to obtain new or renew existing permits and/or licences required for lawful operations
- Non-compliance with applicable EHS standards and requirements
- Failure to discharge duty of care in operational activities
- Insufficient qualified expertise to ensure compliance with applicable law and regulations

Potential impact on Group

- Potential civil and/or criminal liability for loss of life or injury.
- Potential liability for clean-up costs
- Financial impact of damages awards and/or fines and penalties imposed
- Damage to corporate reputation
- Possible impairment of assets and/or closure of operations, resulting in additional costs and potential loss of volume and market share

Principal activities in place to address risk

- Management accountability to ensure appropriate compliance mechanisms are in place, including a registry of applicable licences and permits and the tracking of local legislative requirements and developments
- EHS governance and committees in place at individual market level, monitored at regional level, to oversee compliance
- Provision of appropriate EHS training, information and communications at all levels
- Dedicated global team to provide support in the management of EHS risks
- Key issues and incidents monitored regionally and reported globally

Key Group risk factors continued

Regulation

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

Regulation inhibits Growth strategy

There is a risk that the enactment of regulation that is not evidence based will put the Group at a competitive disadvantage, interfere with its ability to differentiate its products and increase costs and complexity.

Principal relevance to Group strategy

Potential impact on Growth (organic revenue growth)

Time frame Long term

Principal potential causes

- Adoption of FCTC guidelines and adoption of more stringent national regulations
- 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 which increases complexity and cost

Potential impact on Group

- Contribution to the denormalisation of smoking
- Erosion of brand value and adverse impact on ability to communicate and build brand equity
- Increased cost of business for legitimate industry, lower turnover and reduced profits
- Reduced ability to communicate brand portfolio and innovations contributing to an increase in illicit trade

Principal activities in place to address risk

- Group companies have regulatory strategies in place in order to identify issues material to their operating environment and develop plans to address them in a manner consistent with local law and Group policy
- Engagement is sought with scientific and regulatory communities within the context of the FCTC process, and stakeholder engagement takes place at global, regional and individual market levels
- Establishment of a dedicated Regulatory Futures team to monitor regulatory trends and developments, analyse regulatory proposals to determine impacts, if any, on business and develop initiatives in response
- Development of dedicated technical and advocacy capabilities, corporate positions and best practice examples, supported by training, for markets to address regulation

Regulation (continued)

Reduced ability to meet consumer expectations and increased compliance costs

Restrictive regulation, in particular in relation to the content and design of tobacco products, may impair the Group's ability to meet consumer expectations and may also lead to increased operating costs and reduced sales

Principal relevance to Group strategy

Potential impact on **Growth** (organic revenue growth)

Time frame Long term

Principal potential causes	Potential impact on Group
<ul style="list-style-type: none"> Adoption of FCTC guidelines on product design, contents and emissions and testing and measuring Product regulation aimed at reducing the appeal of cigarettes through severe restrictions on ingredients and design Regulation on the content and design of tobacco products which increases complexity and cost 	<ul style="list-style-type: none"> Reduced consumer acceptability of new product specifications, leading to loss of volume and contributing to an increase in illicit trade Loss of volume due to regulation in individual markets impacting on established portfolio Cost complexity of meeting regulations Loss of reputation, penalties and closure of production as a result of non-compliance

Principal activities in place to address risk

- Establishment of Leaf Blending Innovation Centre in Brazil to explore and develop product solutions that are consumer relevant within the developing regulatory context
- Development of standardised product platforms and a rationalised brand/product portfolio to reduce the compliance testing and reporting costs
- Effective and globally integrated processes for sales and operations planning processes, product specification and new product initiatives
- Programme of engagement with scientific and regulatory authorities within the context of the FCTC process

Loss of ability to directly communicate with consumer

Strict and restrictive regulation may reduce the Group's ability to communicate with adult smokers and may also impact on its ability to communicate with its corporate stakeholders

Principal relevance to Group strategy

Potential impact on **Growth** (organic revenue growth) and **Responsibility** (balanced regulation)

Time frame Long term

Principal potential causes	Potential impact on Group
<ul style="list-style-type: none"> Adoption of FCTC guidelines on packaging and labelling, advertising and promotion Adoption of more stringent national regulations, such as point of sale display bans and plain packaging 	<ul style="list-style-type: none"> Generic or plain packaging leads to loss of brand equity Lower margins through reduced ability to build brand equity and leverage price Reduced ability to compete and make new market entries Reduced volumes and impact on profits

Principal activities in place to address risk

- Development of comprehensive plans to support markets to prepare for the implications of an increasingly strict regulatory environment and to address key regulatory issues
- Development of innovative solutions to evolve brand portfolio, product and design and product differentiation within the context of regulatory developments and consistent with Group policy and local law
- Programme of engagement with stakeholders at global, regional and individual market levels to address key regulatory issues, including plain packaging and product display initiatives, and identify potential unintended consequences, such as a contribution to increased illicit trade

Board of Directors

	Richard Burrows (66) Chairman	Sir Nicholas Scheele (68) Senior Independent Non-Executive Director	Nicandro Durante (55) Chief Executive
Nationality	Irish	British/US	Brazilian/Italian
Position	Chairman since November 2009, Non-Executive Director (NED) since September 2009, and Chairman of the Nominations Committee	Senior Independent Non-Executive Director since 2008. Non-Executive Director (NED) since 2005, and member of the Audit, Nominations and Remuneration Committees	Chief Executive since 1 March 2011
Key appointments	NED and member of the Remuneration Committee of Rentokil Initial, a Supervisory Board Member at Carlsberg, and member of The Trilateral Commission	Chairman of The Cambridge-MIT Institute, Key Safety Systems, Inc (USA) and Global Metals SA de CV (Mexico) and a Director of Grupo Proeza (Mexico)	No external appointments
Skills and experience	Chief Executive of Insh Distillers, Co-Chief Executive of Pernod Ricard, Governor of the Bank of Ireland, Fellow of the Institute of Chartered Accountants of Ireland	President and Chief Operating Officer of Ford Motor Company; knighted in 2001 for services to British exports, and Chancellor of Warwick University from 2002 until 2008	COO from 2008, Regional Director for Africa and Middle East and member of the Management Board from 2006, senior general management roles in Brazil (including President of Souza Cruz) and in the UK and Hong Kong, has wide experience in senior international finance and management roles within the Group. Holds a degree in finance, economics and business administration
	Ben Stevens (52) Finance Director and Chief Information Officer	John Daly (55) Chief Operating Officer	Karen de Segundo (65) Non-Executive Director
Nationality	British	Irish	Dutch
Position	Finance Director since 2008, additionally Chief Information Officer since 2010	Chief Operating Officer since September 2010	Non-Executive Director (NED) since 2007, Chair of the Corporate Social Responsibility Committee, and member of the Nominations and Remuneration Committees
Key appointments	No external appointments	Non-Executive Director of Reynolds American Inc	NED and member of Audit & Risk, Nomination, Remuneration and Safety & Sustainability Committees of Lonmin plc, Supervisory Board Member at E.ON AG, and Member of the Board of Pöyry Oyj
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	Marketing Director, P J Carroll & Company (Ireland), senior management roles in Europe and the Far East; and Area Director Middle East & North Africa. Appointed to the Management Board as Regional Director for Asia-Pacific October 2004. Holds a Diploma in Marketing and an International MBA	Senior executive roles before retiring as CEO Shell International Renewables and President Shell Hydrogen in 2005. Holds a Masters degree in Law from Leiden University, an MBA from Michigan State University and is a Council Member of the Anglo-Netherlands Society

Ann Godbehere (56)
 Non-Executive Director

Canadian/British

Non-Executive Director (NED) since 3 October 2011, Member of the Corporate Social Responsibility, Nominations and Remuneration Committees

NED, member of the Nominations Committee and Chair of the Audit Committee of Rio Tinto plc, member of the Audit and Corporate Responsibility Committees and Chair of the HR and Compensation Committee of UBS AG, NED and Chair of the Audit Committee of Prudential plc, NED of Arel Holdings Ltd, Atrium Underwriting Group Ltd and Atrium Underwriters Ltd

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

Robert Lerwill (60)
 Non-Executive Director

British

Non-Executive Director (NED) since 2005, Chairman of the Audit Committee, and member of the Nominations and Remuneration Committees

Chairman of Synergy Health plc and Chairman of its Nomination Committee and member of its Remuneration Committee, and NED and Chairman of the Audit Committee of Transcom Worldwide S A

Chartered Accountant, a Director of Cable & Wireless plc and WPP Group PLC and Chief Executive of Aegis Group plc until 2008

Christine Morin-Postel (65)
 Non-Executive Director

French

Non Executive Director (NED) since 2007, member of the Nominations and Remuneration Committees

NED of Royal Dutch Shell PLC and EXOR S p A (Italy)

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

Dr Gerard Murphy (56)
 Non-Executive Director

Irish

Non Executive Director (NED) since 2009 and member of the Corporate Social Responsibility, Nominations and Remuneration Committees

Member and Chairman of the Executive Committee of The Blackstone Group International Partners LLP, NED of the British Venture Capital and Private Equity Association Ltd, member of the Management Committee of Merlin Entertainments Group Ltd, and member of the Supervisory Board of Jack Wolfskin Ausrüstung für Draussen GmbH & Co

Chief Executive Officer of Kingfisher plc, Carlton Communications plc, Exel plc, Greencore Group plc, senior operating roles at Diageo plc. Holds a BSc and PhD in food technology from University College Cork and an MBS in Marketing from University College Dublin

Kieran Poynter (61)
 Non-Executive Director

British

Non-Executive Director (NED) since 2010, and member of the Corporate Social Responsibility, Nominations and Remuneration Committees

NED and Chairman of the Audit Committee of International Consolidated Airlines Group S A, NED and member of the Remuneration, Audit, Risk & Compliance and Nomination Committees of F&C Asset Management PLC, Chairman and NED of Nomura International PLC, and NED of The Royal Automobile Club Ltd

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

Anthony Ruys (64)
 Non-Executive Director

Dutch

Non Executive Director (NED) since 2006, Chairman of the Remuneration Committee and member of the Audit and Nominations Committees

Chairman of the Supervisory Board of NV Luchthaven Schiphol (NL), member of the Supervisory Boards of the Rijksmuseum and JANIVO Holdings BV (NL), and NED of the Group's Indian associate, ITC Limited

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

Management Board

Jack Bowles (48) Director, Americas

Nationality	French
Position	Director, Americas since October 2011
Skills and experience	Joined the Group in 2004, became President of British American Tobacco France in 2005, appointed Managing Director of the Company's publicly listed subsidiary, British American Tobacco Malaysia, in 2007, appointed to the Management Board as Director, Western Europe in October 2009, and Chairman of Souza Cruz in Brazil

Mark Cobben (55) Director, Western Europe

Nationality	Dutch
Position	Director, Western Europe since October 2011
Skills and experience	Joined the Group in 1993, General Manager in Switzerland, Argentina, Russia and Germany, joined the Management Board as Regional Director for Latin America and the Caribbean in October 2007, appointed Director, Americas in January 2009

David Fell (51) Director, Asia-Pacific

Nationality	British
Position	Director, Asia-Pacific since September 2010
Skills and experience	Joined the Group in 1989, appointed President of British American Tobacco Japan in 2000, became Area Director, British American Tobacco Australasia and Managing Director, British American Tobacco Australia in October 2004, appointed to the Management Board as Director, Eastern Europe in April 2008

Giovanni Giordano (46) Group Human Resources Director

Nationality	Italian/US
Position	Group Human Resources Director since June 2011
Skills and experience	Joined the Group and appointed to the Management Board in June 2011, an international human resources career with wide experience in senior roles at Procter & Gamble and Ferrero, where he was Chief Corporate Officer

Andrew Gray (47) Director, Eastern Europe, Middle East and Africa

Nationality	Brazilian/British
Position	Director, Eastern Europe, Middle East and Africa since January 2011
Skills and experience	Joined the Group in 1987, held a variety of senior marketing and general management roles in South America (including President of Souza Cruz in Brazil) and also in Central America, the Caribbean and Malaysia, joined the Management Board as Director, Africa and Middle East region in January 2008

Jean-Marc Lévy (49) Group Marketing Director

Nationality	Swiss
Position	Group Marketing Director since January 2010
Skills and experience	Joined the Group in 1994 as Marketing Director in Switzerland, held a variety of marketing and general management roles in Europe and South East Asia, joined the Management Board as Director, Western Europe in April 2008

Des Naughton (45)
Group Operations Director

British

Group Operations Director since
June 2011

Joined the Group in 1995, held a number of general management and marketing roles including Global Brand Director for Dunhill and General Manager, South Korea, Regional Head of Marketing, Africa and Middle East, joined the Management Board as Director, Eastern Europe in September 2010 becoming Group Operations Director Designate on 1 January 2011

Dr David O'Reilly (45)
Group Scientific Director

British

Group Scientific Director since
January 2012

Joined the Group in 1991, has held various positions in Group Research & Development (GR&D) most recently as Head of GR&D, Head of International Public Health & Scientific Affairs, appointed Group Scientific Director, a new position on the Management Board, on 1 January 2012

Michael Prideaux (61)
Group Corporate and
Regulatory Affairs Director

British

Group Corporate and Regulatory Affairs
Director since 1998

Joined the Group in 1989, previously Chief Executive of Charles Barker City, a leading financial and corporate public relations, advertising and design agency, appointed Group Corporate and Regulatory Affairs Director and a member of the Management Board in 1998 following the demerger of B A T Industries. Michael will retire from British American Tobacco at the end of June 2012

Naresh Sethi (45)
Group Business
Development Director

Indian/Australian

Group Business Development Director
since January 2012

Joined the Group in 2001, has held various marketing roles in Australasia, Indonesia, West Africa and Japan where he was Marketing Director and, later, the Group's General Manager; appointed Group Business Development Director, a new position on the Management Board, on 1 January 2012

Kingsley Wheaton (39)
Deputy Corporate and
Regulatory Affairs Director

British

Deputy Corporate and Regulatory Affairs
Director since January 2012

Joined the Group in 1996, has held various marketing roles in the Middle East and West Africa before becoming Marketing Director in Nigeria and Russia and, later, General Manager in Russia. Most recently Global Brand Director for Kent and Vogue

Neil Withington (55)
Group Legal and Security
Director and General Counsel

British

Group Legal and Security Director and
General Counsel since 2000

Joined the Group in 1993 after a career at the Bar and in the pharmaceutical industry, Group's Deputy General Counsel, appointed to the Management Board as Legal Director and General Counsel in August 2000; a Non Executive Director of Reynolds American Inc since 2004

Corporate governance statement

Richard Burrows
Chairman

Chairman's introduction

At British American Tobacco, we remain committed to high standards of corporate governance. This is central to the continued strong performance of the business in a manner which is sustainable in the long term and to maintaining the confidence of investors. For us, good governance is about managing the business effectively and responsibly and in a way which is honest, transparent and shows accountability.

On the following pages, we set out our approach to governance at British American Tobacco. We explain how the Board and its Committees are structured, how they operate and what they have done in the year, as well as how their effectiveness is evaluated. There are benefits, we believe, to being transparent. We are therefore broadly supportive of the Government's efforts to encourage more effective narrative reporting and we said as much in our response to its recent consultation in this area. We try to ensure that our reporting on governance matters is clear, concise and well-structured, that it is relevant and accessible to users, and that it facilitates the comparative analysis of the information provided. We seek to minimise 'boiler plate' by preparing a separate report against the UK Corporate Governance Code (the Code), which we publish on our www.bat.com website, although it is of course still important to ensure that this corporate governance statement meets the requirements of the Code. The quality of our narrative reporting was recognised in 2011, with the Company being awarded first place in the People Reporting and Executive Remuneration Reporting categories for the FTSE 100 in the PricewaterhouseCoopers Building Public Trust Awards. Thony Ruys, the Chairman of our Remuneration Committee, discusses our approach to executive remuneration, another topic which has been the subject of much recent debate, in his introduction to the remuneration report.

As a Board, we have ultimate responsibility for the Group's performance and for overseeing the management of nsk. We are keenly aware that the shareholders also look to us to promote the long-term success of the Company and I recognise that, as Chairman, it is my role to provide the leadership to enable it to do so effectively. This year's evaluation of the Board, which for the second year running was facilitated externally, confirmed that the Board continues to meet these obligations. One aspect of the evaluation which we considered in detail this year was a review of the skills required by the Board and I am delighted to welcome Ann Godbehere to the Board following her appointment in October. Our search for further non-executive appointments continues.

For us, good governance is about managing the business effectively and responsibly and in a way which is honest, transparent and shows accountability.

www.bat.com/governance

The Board takes seriously its responsibility for promoting the Group's values and, in particular, for ensuring that everyone within the Group is aware of their responsibility not only to act lawfully, but also to conduct themselves at all times with high standards of business integrity. These values are embodied in our Standards of Business Conduct, which were updated in September 2011 to ensure that they continue to reflect best business practice and that they are aligned with the provisions of the UK Bribery Act, which came into effect in July 2011. Corruption causes distortion in markets and harms economic, social and political development. We have long made it clear that it is wholly unacceptable for our companies and employees to be involved or implicated in any way in corrupt practices, and we continue to keep our anti-corruption policies and practices under review to ensure that they fully reflect this approach.

A further area of focus for us in 2011 was a review of our arrangements for ensuring the continued independence and objectivity of our external auditors. We consider that our relationship with PricewaterhouseCoopers is satisfactory but it is nevertheless important to guard against complacency. With support from its Audit Committee, the Board continues to satisfy itself as to both their effectiveness and their independence. Following the publication of revised guidance by the Financial Reporting Council, we have taken the opportunity to review and update our policy on auditor independence and we explain the revised policy in more detail in the section on audit and accountability.

One of the highlights of 2011 was the reclassification of the shares comprising our secondary listing on the JSE Limited in South Africa as domestic assets, allowing South African institutions to hold a greater number of shares in the Company. This very positive outcome followed a programme of engagement with the relevant authorities and our institutional investors in South Africa.

As I hope this report demonstrates, good corporate governance continues to be a key focus for the Board and this, combined with our clear and consistent strategy, means that the Company is well equipped to continue returning value to its shareholders. As we head towards our Annual General Meeting in April, I look forward to meeting with a number of you, both in the run up to the meeting and at the meeting itself, which this year will be held at a new venue, The Banqueting House in Whitehall, London.

Richard Burrows
Chairman



Compliance statement

The principal governance rules applying to UK companies listed on the London Stock Exchange are contained in the UK Corporate Governance Code adopted in June 2010 (the Code). The Code is published by the Financial Reporting Council (FRC) and is available from its website (www.frc.org.uk).

This statement reports on how the Company has applied the Main Principles of the Code and provides our formal report on compliance with the Code's Provisions.

The Board considers that this Statement provides the information necessary to enable shareholders to evaluate how the Main Principles of the Code have been applied, that the Company has complied with the Provisions of the Code throughout the year and that it has therefore satisfied its obligations under the Code.

To the extent that it is not specifically included in this corporate governance statement, the information required by section 7.2 of the Disclosure Rules and Transparency Rules is included in the section entitled other statutory and regulatory information and is incorporated herein by reference.

In the interests of further transparency, we have again prepared a report which summarises the matters addressed in this statement, as appropriate, by reference to each Principle and Provision of the Code. The updated report is available on the corporate governance section of www.bat.com.

Corporate governance statement continued

The Board

The Board is collectively responsible to the Company's shareholders for the long-term success of the Group and for its overall strategic direction, its values and its governance. It provides the leadership necessary for the Group to meet its business objectives within the framework of its internal controls, while also discharging the Company's obligations to its shareholders.

The Board's principal responsibilities include:

- Approving the Group's business strategy and ensuring that an effective management team and the necessary financial and human resources are in place for the Group to meet its objectives
- Agreeing the Group Budget
- Approving the Company's Annual Report and reviewing its periodic financial reports
- Declaring an interim dividend and recommending a final dividend
- Agreeing the agenda for the Annual General Meeting
- Agreeing Board succession plans and considering the evaluation of the Board's performance over the preceding year
- Reviewing the Company's risk management and internal control systems
- Agreeing the Company's governance framework and approving the Standards of Business Conduct and other Group policies

Directors

As at the date of this Annual Report, the Company has a Board of 12 Directors:

Chairman
Richard Burrows

Executive Directors
Nicandro Durante (Chief Executive)
Ben Stevens (Finance Director and Chief Information Officer)
John Daly (Chief Operating Officer)

Non-Executive Directors
Sir Nicholas Scheele (Senior Independent Director)
Karen de Segundo
Ann Godbehere
Robert Lerwill
Christine Monn-Postel
Dr Gerry Murphy
Kieran Poynter
Anthony Ruys

Nicandro Durante, formerly Chief Operating Officer, became Chief Executive on 1 March 2011, following Paul Adams's retirement from the Board and as Chief Executive on 28 February 2011. Ana Mana Llopis retired from the Board following the conclusion of the Company's Annual General Meeting on 28 April 2011. Ann Godbehere was appointed to the Board as a Non-Executive Director with effect from 3 October 2011.

Biographical and related information about the Directors, including details of relevant skills and experience, is given on the Board of Directors pages.

Chairman and Chief Executive

The Chairman and Chief Executive are responsible for the profitable operation of the Group. Their roles are separate, with each having distinct and clearly defined duties and responsibilities.

The Chairman is responsible for leadership of the Board, for ensuring its effectiveness on all aspects of its role and for facilitating the productive contribution of all Directors. He sets the agenda for Board meetings in consultation with the Chief Executive and the Company Secretary. He is also responsible for ensuring that the interests of the Company's shareholders are safeguarded and that there is effective communication with them. The Chairman is accountable to the Board for leading the direction of the Group's corporate and financial strategy and for the overall supervision of the policies governing the conduct of the Group's business.

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

Non-Executive Directors

The role of the Non-Executive Directors is to help develop strategy and, where appropriate, to provide constructive challenge to management's proposals. They are responsible for scrutinising the performance of management in meeting agreed goals and objectives and for monitoring the reporting of performance. All of the Non-Executive Directors remain available to meet with major investors in order to understand their views and concerns.

Senior Independent Director

Sir Nicholas Scheele is the Senior Independent Director. He is responsible for leading the review of the Chairman's performance with the other Non-Executive Directors. When required, he presides at meetings of the Board and shareholders in the absence of the Chairman. He serves as intermediary for the other Directors where necessary and is available to shareholders should occasion arise where there is a need to convey concerns to the Board other than through the Chairman or the Chief Executive.

Board composition

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

Meetings of the Board

The Board held eight meetings in 2011, seven of which were scheduled and one of which was convened to consider a proposal for the Company to provide a guarantee to the Trustee of the British American Tobacco UK Pension Fund in respect of the liabilities of certain UK Group companies. In 2011, the Board decided to reduce the number of its scheduled meetings in future years in order to promote the more efficient use of Directors' time while also reducing costs. Future meetings will be longer to ensure that the full forward calendar of agenda items continues to be addressed effectively and so that the work of the Board and its Committees is not compromised. Accordingly, the Board is scheduled to hold six meetings in 2012.

Board meeting attendance

Name	Meetings attended	Meetings eligible to attend
Richard Burrows	8	8
Sir Nicholas Scheele	7	8
Paul Adams ¹	1	1
Nicandro Durante	8	8
Ben Stevens	8	8
John Daly	8	8
Karen de Segundo	8	8
Ann Godbehere ²	2	2
Robert Lerwill	7	8
Dr Ana Mana Llopis ³	3	3
Christine Morin-Postel	6	8
Dr Gerry Murphy	8	8
Kieran Poynter	7	8
Anthony Ruys	8	8

Notes

- 1 Paul Adams retired from the Board and as Chief Executive on 28 February 2011.
- 2 Ann Godbehere was appointed to the Board as a Non-Executive Director with effect from 3 October 2011.
- 3 Dr Ana Mana Llopis retired from the Board immediately following the Company's Annual General Meeting on 28 April 2011.

Those Directors who were absent from one meeting were unable to attend the ad hoc meeting arranged at short notice. In addition, Christine Morin-Postel was unable to attend one of the scheduled meetings due to a long-standing prior engagement.

The Chairman will always seek to obtain consensus at Board meetings but, where necessary, decisions will be taken by majority. If any Director has concerns about the running of the Company or a proposed action which cannot be resolved, such concerns will be recorded in the Board minutes. No such concerns arose in 2011. If required, the Non-Executive Directors, led by the Chairman, meet prior to meetings of the Board without the Executive Directors present. Both the Executive and the Non-Executive Directors also meet annually, led by the Senior Independent Director and without the Chairman present, in order to appraise the Chairman's performance.

Board Committees

The Board has established four principal Board Committees, to which it has delegated certain of its responsibilities. They are the Audit Committee, the Corporate Social Responsibility (CSR) Committee, the Nominations Committee and the Remuneration Committee. The roles, membership and activities of these Committees are described in more detail later in this corporate governance statement and, in the case of the Remuneration Committee, in the remuneration report. Each Committee has its own terms of reference, which are kept under review and updated regularly to ensure that they remain consistent with best practice. The current terms of reference were reviewed in 2010 to ensure alignment with the UK Corporate Governance Code and, following adoption by the Board in December 2010, they came into effect on 1 January 2011. They are available on www.bat.com.

In 2011, the Board also established a Corporate Committee comprising the three Executive Directors, which has responsibility for reviewing Group corporate and governance issues prior to their referral for consideration by the Board and its other Committees.

Corporate governance statement continued

Key activities of the Board in 2011

Growth

The Board kept under review the Group's performance throughout 2011, taking into account global economic conditions and the impact of political upheaval, such as the Arab Spring uprisings in North Africa and the Middle East, and natural disasters, such as the earthquake and tsunami in Japan and the floods in Australia. It considered the impact of foreign exchange rate movements, pricing and excise issues and challenges from illicit trade, and kept under review marketing and brand initiatives in key markets. It satisfied itself throughout the year that, despite continued difficult trading conditions, management remained on track to deliver the strategy.

The Board regularly considered opportunities for growth through strategic acquisitions, overseeing the acquisition of Protabaco in Colombia and the extension of the Group's shareholding in Chiletobacos in Chile. It considered post-implementation reviews of the acquisitions of Tekel in Turkey and STK in Denmark.

It regularly reviewed the Group's liquidity, including the issuance of commercial paper and adherence to its financing principles, and continued to satisfy itself that management was making sufficient provision in this regard. In particular, it kept under review the implications of a possible default in the Eurozone and the impact of such an event on the Group's financing.

Productivity

The Board continued to oversee initiatives aimed at managing costs, increasing efficiencies and leveraging the Group's global reach. It noted the progress being made in the programmes established to develop the Group's revised Operating Model and to implement a single IT operating system throughout the Group, which are anticipated to deliver significant cost savings in future years.

Responsibility

The Board continued to receive regular updates on the key regulatory issues facing the Group, focusing on pack space appropriation, product regulation and retail display bans. It monitored, in particular, developments in connection with the proposed introduction of plain packaging in Australia, the proposed UK retail display ban and the EU Products Directive.

The Board visited the Group's R&D facilities in Southampton and received briefings on the science-based approach being taken towards the development of potentially reduced-nicotine products. It requested a detailed annual update on the Group's R&D activities. The Board also monitored developments in relation to Nicoventures Limited, a company established to focus exclusively on the development and commercialisation of innovative, regulatory-approved nicotine products.

The Board received a briefing on the Group's anti-corruption policies and procedures and the recommended enhancements following an internal review to ensure continued alignment with best practice and the UK Bribery Act and its associated guidance. In this context, it approved a revised version of the Group's Standards of Business Conduct, which took effect from 1 September 2011.

Winning organisation

The Board reviewed succession planning in consultation with the Nominations Committee. It considered in detail the skills which will be desirable in relation to future non-executive appointments, noting the likely importance of entrepreneurial and science-based skills, experience in relation to the Far East and skills relating to the use of new media in a consumer-facing business. It kept under review the steps being undertaken to identify further non-executive appointments and considered and approved the Committee's recommendation to appoint Ann Godbehere to the Board as a Non-Executive Director.

The Board considered the issue of board diversity, the recommendations made by Lord Davies in his report entitled *Women on Boards* and the FRC's consultation on proposed consequential changes to the UK Corporate Governance Code. It approved the Chairman's Statement on Board Diversity prepared in accordance with Lord Davies's recommendations and published on www.bat.com in September 2011.

The Board also reviewed proposed appointments at Management Board level (see key activities of the Nominations Committee) and approved the creation of two new posts on the Management Board, namely Group Scientific Director and Group Business Development Director, reflecting the importance to the Group of these areas.

Management Board

The Management Board has responsibility for overseeing the implementation by the Group's operating subsidiaries of the policies and strategy set by the Main Board, and for creating the framework for their successful day-to-day operation. The Management Board is chaired by the Chief Executive and its other members are the Finance Director, the Chief Operating Officer and the 12 senior Group executives, whose names appear on the Management Board pages. It held 11 scheduled

meetings in 2011 (nine in 2010), including two three-day meetings held off-site, primarily to consider strategic matters. In addition, one further meeting was held to consider longer term challenges and opportunities. The Management Board is scheduled to hold 11 meetings in 2012, including the two off-site strategy meetings. Members of the Management Board are invited to attend meetings of the Board from time to time, in particular when the Group's strategy and Budget are under discussion.

Conflicts of interest

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

During 2011, a number of conflicts were notified to the Company in accordance with these procedures. All matters authorised by the Board and the Conflicts Committee were recorded in the register of interests maintained by the Company Secretary. They included the consideration, prior to her appointment to the Board, of Ann Godbehere's other directorships, including her positions on the boards of UBS AG, the Company's corporate broker and a provider of other financial and advisory services to Group companies, and Prudential plc, a potential supplier of services to Group companies.

In addition, a potential conflict of interest for Christine Morin-Postel arose during 2011 in respect of the Group's exposure to clean-up costs for pollution in the Lower Fox River, Wisconsin. Group companies have potential direct or indirect causes of action against French company Sequana SA in relation to dividend payments made to Sequana SA by a former subsidiary of it, which subsidiary the Group believes provides an indemnity to it in relation to the clean-up costs. Ms Morin-Postel is a non-executive director of a shareholder in Sequana SA. To date, she has absented herself from any Board or Audit Committee meetings of the Company when the Fox River matter has been discussed. She stood down from the Audit Committee with effect from 21 February 2012 and will continue to absent herself from Board discussion of the matter in the future.

Information and professional development

All Directors receive induction on joining the Board, covering their duties and responsibilities as directors. 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, and they may request such further information as they consider necessary. The expected time commitment from Non-Executive Directors for their induction has been formalised in the standard letter of appointment following the outcome of the Board evaluation for 2010 (see below) and visits to an overseas factory location and the Group Research & Development Centre in Southampton are specified as required elements of the induction.

All Directors receive briefings designed to update their skills and knowledge on a regular basis, for example in relation to the business and on legal and regulatory requirements, and by visits to company sites. Non-Executive Directors have historically also made use of the opportunity to attend meetings of the

Group's regional audit and CSR committees. From 2012, it is proposed that such meetings will take place in the Group's UK head office, to facilitate the efficient use of management time. The Non-Executive Directors will each be invited to accompany a Regional Director on a scheduled market visit in order to ensure that they continue to receive regular exposure to the Group's business 'on the ground'. In this regard, market visits to Australia, Colombia, Spain and Turkey are currently planned for 2012.

The Chairman meets separately with each Non-Executive Director in October each year in order to discuss their individual training needs, development plans and the pattern of their future service. Following the outcome of the Board evaluation for 2010 (see below), these meetings have been incorporated within the formal annual review process for the proposed re-election of Non-Executive Directors.

Following her appointment, Ann Godbehere attended induction briefings covering the Group's strategy, its organisational structure and its business functions and activities, including its statutory reporting cycle and financing principles, research and development activities, information technology strategy and legal and regulatory issues. She also attended sessions addressing corporate governance, the Group's internal control and risk management framework and the role of the external auditors. Her induction briefings are continuing, and she is due to receive a briefing on environmental health and safety issues and to visit the Group's factory in Bayreuth, Germany.

The full Board received briefings on a number of legal and regulatory developments, including the outcome of Lord Davies's review of gender equality on the boards of UK listed companies, the government's consultation on narrative reporting (delivered by an external presenter) and developments in relation to the Bribery Act 2010.

The Board and its Committees receive high quality, up-to-date information for review in good time ahead of each meeting, and the Company Secretary, under the direction of the Chairman, ensures good information flows within the Board and its Committees and between the Non-Executive Directors and senior management. She is also responsible for advising the Board, through the Chairman, on all governance matters. The appointment and removal of the Company Secretary is a matter for the Board. In accordance with the recommendations arising from the 2010 Board evaluation (see below), a direct reporting line for the Company Secretary to the Chairman was established with effect from October 2010.

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

Corporate governance statement continued

Evaluation of Board performance

Following the comprehensive report and findings which resulted from the 2010 Board Evaluation (see below), the Board once again appointed Simon Osborne and Geoffrey Shephard from the Institute of Chartered Secretaries and Administrators (ICSA) to conduct a follow up Board and Committee evaluation for 2011. This also included a more detailed peer-based evaluation of the personal effectiveness of each Director.

The key areas for the review were based on the topics which had been discussed the previous year and included

- the role of the Board, its responsibilities and those of its Committees,
- how the Board oversees risk, business conduct and corporate governance,
- the arrangements for, and effectiveness of, Board meetings,
- the support and training provided to the Board,
- Board composition, range of skills required, succession planning and effectiveness of the Chairman, Senior Independent Director and Committee Chairmen,
- how the Board works together and its engagement with shareholders, and
- outcomes and achievements, including how the Board is perceived externally.

John Daly, who had joined the Board after completion of the 2010 evaluation, was interviewed by Simon Osborne. All other Directors were sent a transcript of their 2010 discussion and asked to update their comments with their thoughts on the progress of the Board over the preceding year. Each Director was required to give an assessment ranging from Poor through to Excellent on each of the core issues.

In addition, each Director assessed themselves, and all the other Directors – both Executive and Non-Executive and the Chairman – against a number of personal effectiveness criteria, including awareness of the Group strategy, ability to think strategically and challenge constructively, level of commitment and preparedness, communication and listening skills, and contribution to decision-making. The Chairman was also assessed on his ability to create the conditions for overall Board effectiveness and for setting the tone at the top.

The facilitators collated and analysed the results from each element of the evaluation and prepared separate reports, summarising key points and including non-attributable comments given in individual responses. The Board and Director Reports were initially discussed with the Chairman. The Board report was then presented by ICSA at a Board meeting. Each Director received a copy of the report on his or her own effectiveness and those reports on individual performances were discussed by the Chairman with each Director as appropriate. The Chairman's performance was discussed initially with the Senior Independent Director before he provided feedback to the Chairman.

The Board evaluation for 2012 will be facilitated by the Company Secretary and it is anticipated that in the future it will be facilitated externally at least once every three years.

Evaluation of Board performance

Update on 2010 objectives

Throughout 2011, the Board monitored progress towards achievement of the specific action points arising from its first externally facilitated evaluation. Details are set out below.

- **Carry out a review of the size and composition of the Remuneration Committee.** At least one additional meeting has been scheduled in 2012 and a revised forward agenda has been established. For the time being, all independent Non-Executive Directors will continue to be members of the Committee. Further details of the review are provided in the remuneration report.
- **The Remuneration Committee to receive a formal report following the annual appraisal of each member of the Management Board.** In February 2011, the Chief Executive provided a full update to the Committee on the performance of each member of the Management Board. This process will be repeated annually.
- **Each Committee to review the 2010 report's specific comments relating to its activities as well as any generally applicable action points.** These reviews have been carried out and, as a result, each Committee has updated its forward calendar of specific agenda items and considered its role and responsibilities, for example with regard to risk oversight.
- **Review the process for the proposed re-election of Directors.** A formal two-stage process was introduced in February 2011. This involves a discussion between the Chairman and each Non-Executive Director in October each year and formal consideration by the Nominations Committee in the following February, with each Director being absent from the meeting while his or her own position is discussed.
- **Establish a direct reporting line for the Company Secretary to the Chairman in relation to Board matters.** This was introduced with effect from October 2010.
- **The Nominations Committee to have particular regard to a person's ability to influence outcomes when considering non-executive appointments.** An ability to influence and provide constructive challenge has always been a key requirement. This point was re-emphasised with the search firms engaged in 2011 to find further non-executive directors and in the role specification which was prepared.
- **Review the calendar of standard Board and Committee agenda items.** The Board and each of the Committees have reviewed and updated the standard calendar of agenda items and also regularly reflect on the balance between pre-read and presentation at their meetings.
- **Review the induction arrangements for non-executive directors.** These arrangements are reviewed with every new appointment and the time commitment expected for the induction is now specified in the appointment letter.

- **Implement a Board software solution to facilitate secure electronic delivery of papers.** A secure electronic delivery system was introduced in September 2011 as an interim measure. Following a formal tender process, it is expected that the Blueprint Boardpad 2 software will be implemented by April 2012.

Outcome of 2011 evaluation

Board performance The 2011 evaluation showed that the Board continues to be effective. The assessments showed that the Board is rated highly in each category, with only marginal variations from the previous year's ratings. It was considered that the Board had discharged its role and responsibilities effectively and that, during the year, it had focused particularly on longer-term strategic issues, such as opportunities for speedier growth, the threats from increased illicit trade and the challenges posed by further regulation. The Board's continuing focus on succession was highlighted by the smooth transition between the retiring Chief Executive, Paul Adams, and his successor, Nicandro Durante, and also by the appointment of Ann Godbehere in October 2011.

The Board's working relationship with its four principal Committees was considered to have improved during the year. The CSR Committee has benefitted from a revised schedule of meetings and the Remuneration Committee has agreed that it will hold at least one additional meeting in 2012.

With regard to the spread of skills, background and experience on the Board, the evaluation confirmed that the current Directors' backgrounds provide a good mix from both FMCG and financial companies. During 2011, the Board identified a number of additional skills which would also be beneficial to the Company, including science-based skills, experience in relation to the Far East and skills relating to the use of new media in a consumer-facing business.

Director Evaluations The Chairman has discussed each report with the Director concerned and the Senior Independent Director has met with the Chairman to discuss his report with him. Development plans have been agreed and opportunities for Board training and development will be reviewed in 2012.

2011 Action Plan The outstanding action points from 2010 will be fully implemented during 2012, including the introduction of new Board software and implementation of the revised calendar for meetings of the Remuneration Committee. In addition, the Board agreed to review the time allowed in the Board calendar for training and personal development purposes.

Corporate governance statement continued

Shareholder engagement

Relations with shareholders

The Board maintains a dialogue with shareholders directed towards ensuring a mutual understanding of objectives. Its primary contact, facilitated by the Head of Investor Relations, is through the Executive Directors, but the Chairman also contacts major shareholders periodically and in advance of the Annual General Meeting each year in order to understand their views on the Company and to ensure that their views are communicated to the Board as a whole. In addition, the Senior Independent Director and the other Non-Executive Directors are available to meet with major shareholders in order to understand their views and any concerns which they may have.

A full programme of engagement with investors and analysts, both in the UK and overseas, is undertaken each year by the Head of Investor Relations, often accompanied by one or more of the Executive Directors and members of the Management Board, including presentations, roadshows and a bi-annual 'Investor event' involving detailed presentations on the Company's strategy and performance. Investor presentations are published on www.bat.com and results presentations are available by webcast. There is a debt micro site on www.bat.com for debt investors, which includes comprehensive bondholder information on credit ratings, debt facilities, outstanding bonds and maturity profiles.

At least twice a year, the Head of Investor Relations presents a report to the Board on investor relations generally, identifying the key issues raised by institutional shareholders. In addition, the Board receives a report at each of its meetings on any changes to the holdings of the Company's main institutional shareholders. Specific issues raised by individual institutions are also reported to the Board, as appropriate.

During 2011, a wide range of business and corporate governance issues, were discussed with, or raised by, institutional investors as part of the regular investor relations programme. These included the Company's overall performance, how the Chairman had settled into his role, the reinstatement of the share buy-back programme, regulatory developments, pricing issues and the outlook generally for the industry.

In addition, a focused schedule of meetings with key institutional shareholders was undertaken by the Chairman in advance of the Annual General Meeting in April 2011, with discussions covering the Company's performance and governance generally. These included issues such as succession planning and Board evaluation, executive remuneration, Board diversity, the litigation and regulatory environment, external auditors' fees, the reinstatement of the share buy-back programme, and the consultation in late 2010/early 2011 in relation to proposed changes to the Company's Long-Term Incentive Plan.

In October 2011, the National Treasury of South Africa confirmed the reclassification of all inward listed shares on the JSE Limited (JSE), including those comprising the Company's secondary listing on the JSE, as domestic assets. Since the granting of that listing on the JSE in October 2008, the Company had maintained a programme of engagement with the JSE and the South African Reserve Bank (SARB), as well as its institutional investors in South Africa, to encourage the easing of the prudential limits restrictions on the ownership of shares in non-South African companies. Since December 2011, the Company's ordinary shares are now principally included in the South African ALSI40 Index and the SWIX Index. The combined effect of these changes on the Company's secondary listing is likely to be positive, as they potentially allow South African institutional investors to hold a greater number of shares in the Company.

The programme of engagement with investors and analysts for 2011 included an investor event held in Hampshire on 17/18 May, involving presentations by all members of the Management Board, including the Executive Directors, and other senior managers covering a range of topics, including the Group strategy, industry landscape and opportunities, financial performance, consumer engagement and the innovations pipeline and regional challenges. Roadshows were also held in a number of locations including Europe, Japan, Hong Kong, South Africa and North America.

The Company also responded to issues raised in correspondence from shareholders, including providing clarification to an institutional shareholder on questions raised in relation to the Company's relationship with its external auditors, the level of non-audit fees and also regarding the level and treatment of directors' benefits.

Annual General Meeting

The Annual General Meeting will be held at The Banqueting House, Whitehall, London SW1A 2ER at 11.30am on 26 April 2012. Details of the business to be proposed at the meeting are contained in the Notice of Annual General Meeting which is sent to all shareholders and is also published on www.bat.com.

The Annual General Meeting provides a useful opportunity for shareholder engagement and, in particular, for the Chairman to explain the Company's progress and receive questions from investors. The chairmen of the Audit, CSR, and Remuneration Committees are normally available at the Annual General Meeting to take any relevant questions and all other Directors attend, unless illness or another pressing commitment precludes them from doing so. All Directors at the time attended the Annual General Meeting in April 2011, with the exception of Dr Gerry Murphy, who was unable to attend due to a long-standing commitment overseas.

The Company provides for the vote on each resolution to be by poll rather than by show of hands. This provides for greater transparency and allows the votes of all shareholders to be counted, including those cast by proxy. The Chairman announces the provisional voting results at the Meeting, and the final results are announced on the same day through the Regulatory News Service and on www.bat.com. The Company has in recent years appointed an independent assessor to scrutinise the Annual General Meeting and to produce a report of the meeting, covering the proxy voting process, attendance and an audit of the poll procedures. The report in 2011 confirmed the adequacy, accuracy and fairness of the proxy process and the voting procedures and systems. The Company does not intend to appoint an independent assessor for the 2012 Annual General Meeting. It will implement the same procedures used previously.

Stock market listings

The ordinary shares of the Company (as British American Tobacco plc) 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.

Since 28 October 2008, the Company's ordinary shares have had a secondary listing on the JSE Limited in South Africa (JSE), under the abbreviated name BATS and the trading code BT1. As at 31 December 2011, 215,049,297 ordinary shares of the Company (being 10.61 per cent of the Company's issued ordinary share capital – excluding treasury shares) were on its South African branch register for which Computershare Investor Services (Pty) Ltd are share registrars.

The Company's ordinary shares are also traded on NYSE Amex Equities 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 2011, 38,750,804 ADRs were outstanding, represented by 77,501,608 ordinary shares. Citibank, N.A. continues to act as depositary for the ADR programme.

The Company has unlisted trading privileges for the ADR programme and none of its securities are listed on any United States securities exchange or registered pursuant to the securities laws of the United States. As a result, the Company is subject to neither the NYSE Amex Equities listing standards nor the corporate governance rules under the Sarbanes-Oxley Act of 2002. Nevertheless, the Board has chosen, in the interests of good governance, to make a voluntary statement explaining the principal differences and common areas between the Company's corporate governance practices and those that would be required if the Company were subject to those rules. The updated statement will be available on the corporate governance section of www.bat.com from the date of publication of the Annual Report.

Significant shareholders

At 31 December 2011, the following substantial interests (3 per cent 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 22 February 2012, the Company had not received notification either of any change in the interests below or that any other person holds 3 per cent or more of its ordinary shares.

	Number of ordinary shares	% of issued share capital
BlackRock, Inc	132,891,526	6.75
Reinet Investments S.C.A.	84,303,670	4.28
Legal & General Group plc	79,243,066	4.02

Note

The percentage of issued share capital excludes treasury shares.

Audit and accountability

Robert Lerwill
Chairman, Audit Committee

Audit Committee

Current members
Robert Lerwill (Chairman)
Anthony Ruys
Sir Nicholas Scheele

Attendance at meetings in 2011

Name	Meetings attended	Meetings eligible to attend
Robert Lerwill	5	5
Christine Morin-Postel ¹	5	5
Anthony Ruys	5	5
Sir Nicholas Scheele	4	5

Notes

¹ Christine Morin-Postel stood down from the Committee with effect from 21 February 2012

Sir Nicholas Scheele was unable to attend one meeting of the Audit Committee due to a long-standing prior engagement

The Chief Operating Officer and the Finance Director attend all meetings of the Committee but are not members and other Directors attend by invitation. The Committee's meetings are also regularly attended by the Head of Audit and Business Risk, the General Counsel to the Company and a representative of the external auditors.

Robert Lerwill has recent and relevant financial experience.

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

Summary Terms of Reference

The Audit Committee is responsible for

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

The Committee's terms of reference were reviewed in December 2010 and minor updates were made with effect from 1 January 2011. The full terms of reference are available on www.bat.com

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

The Chairman of the Committee reports to the subsequent meeting of the Board on the Committee's work and the Board receives a copy of the minutes of each meeting. The papers considered by the Committee are available to any Director who is not a member, should they wish to receive them.

www.bat.com/boardcommittees

Key activities of the Audit Committee in 2011

The Audit Committee held five meetings during 2011, at which it considered the following standing items of business

- The Group's 2010 results and its 2011 half-yearly results and interim management statements
- 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
- The 2012 Internal Audit Plan
- A report from the Head of Group Security including consideration of security risks and frauds and losses arising during the preceding year
- Compliance with the Group's Standards of Business Conduct and records management procedures
- An annual review of the external auditors' independence

The Committee also carried out its twice yearly review of the Group risk register and considered the following risk topics in detail

- Risks arising in relation to how major projects and programmes are managed within the Group, considered a significant area of potential risk given the importance of implementation of the revised Operating Model and single IT operating system in delivering future costs savings
- Risks arising in connection with the restructuring of the Group's global IT function
- Risks and opportunities for savings and efficiencies arising in relation to the Group's procurement activities and its procurement joint venture with Annheuser-Busch InBev (Agrega), including the various approaches employed to manage third party suppliers
- Key risks to the Group's pension schemes, including asset underperformance, increased longevity and pension regulation, and the strategies in place to mitigate these risks

- Risks arising in connection with litigation involving Group companies, in particular in the Canadian recoupment claims and the Fox River matter in the US (see the statement on contingent liabilities at note 30 in the notes on the accounts)

In addition, the Committee considered a number of other specific matters, including the following

- The Committee agreed the inclusion of recommended impairments as adjusting items in the consolidated financial statements for the year ended 31 December 2010 and an additional impairment in the financial statements for the year under review, in both cases arising from the material underperformance against expectation of the consolidated business in Turkey following the acquisition of Tekel. This was consequential upon excise shocks leading to increased illicit trade and lower volumes and profitability than anticipated
- It considered developments in relation to Group's exposure to clean-up costs for pollution in the lower Fox River, Wisconsin and agreed the inclusion of a provision in this regard in the financial statements for the year under review (see notes 3(h) and 30 in the notes on the accounts)
- It noted a revised internal audit methodology, updated to reflect best practice, and considered the steps being undertaken by internal audit to support the programmes established to develop the Group's revised Operating Model and single IT operating system
- It noted the response submitted by the Committee Chairman to the Call for Evidence in the Inquiry led by Lord Sharman on going concern and liquidity risk
- It reviewed and recommended to the Board an updated policy on auditor independence, intended to formalise the Group's arrangements for ensuring auditor independence and objectivity

During 2011, the Committee considered a report prepared by the Company Secretary on the effectiveness of the Committee as assessed during the evaluation of the Board in 2010, including a review of its standard agenda items. Consequent upon this, it agreed that it would consider, on an annual basis, the Group's pensions arrangements, both in terms of funding and investment strategies, and requested regular reports on the implementation of the programmes established to develop the Group's revised Operating Model and to implement a single IT operating system throughout the Group.

Financial reporting

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

Audit and accountability continued

Business model

The business review includes an explanation of the basis on which the Group generates value and preserves it over the long term and its strategy for delivering its objectives

Going concern

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

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

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

External auditors

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

Auditor independence

The Audit Committee has an established policy aimed at safeguarding and supporting the independence and objectivity of the Group's external auditors. Following the publication by the Financial Reporting Council of additional guidance in this area in 2010 in its revised Guidance on Audit Committees, the Audit Committee took the opportunity during 2011 to review and update this policy.

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

- create a mutual or conflicting interest between any Group company and the external auditor,
- place the external auditor in the position of auditing its own work,
- result in the external auditor acting as a manager or employee of any Group company, or
- place the external auditor in the position of advocate for any Group company.

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

The policy requires the submission to the Audit Committee, typically prior to the year end, of a work plan identifying the total fees for all audit-related services, tax services and other non-audit services which it is anticipated will be undertaken by the external auditor in the following year. Specific itemisation is required for tax services and other non-audit services in excess of the tender thresholds referred to above. Updated work plans must then be submitted to the Audit Committee at the mid-year and year end. In this way, the Audit Committee has full visibility of the Group spend on non-audit services throughout the year, enabling it to discharge its responsibility for keeping such fees under review and ensuring that neither their level nor their nature risk impairing the external auditor's independence and objectivity. A breakdown of audit, audit-related and non-audit fees paid to PricewaterhouseCoopers in 2011 is provided in note 3(d) in the notes on the accounts and is summarised as follows.

Services provided by PricewaterhouseCoopers firms and associates

	2011 £m	2010 £m
Audit services	9.7	9.7
Audit-related services	0.2	0.2
Total audit and audit-related services	9.9	9.9
Tax advisory services	3.8	5.6
Tax compliance	1.3	1.0
Services relating to information technology	0.2	2.1
Other non-audit services	0.4	0.5
Total non-audit services	5.7	9.2

In 2011 non-audit fees paid to PricewaterhouseCoopers amounted to 57.6 per cent of the audit and audit-related fees paid to them (2010 92.9 per cent)

Annual assessment

The Audit Committee assesses annually the qualification, expertise and resources, and independence of the Group's external auditors and the effectiveness of the audit process. The Committee's assessment is informed by an external audit satisfaction survey completed by members of senior management, which it reviews in detail. In 2011, it also had the benefit of the outcome of an assessment by the external auditors' internal review group of the audit team, involving in-depth interviews with the Company's senior managers. The resulting report was presented to the Committee by a member of the review team, allowing the Committee to ask further questions with regard to the quality of the audit. In addition, the Head of Internal Audit, the Company Secretary and the Committee Chair all meet with the external auditors to discuss the progress of the audit and any significant issues are included on the Audit Committee's agenda for consideration during the year.

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

The Committee has recommended to the Board, for approval by shareholders, the reappointment of PricewaterhouseCoopers as the Company's external auditors. Resolutions will be proposed at the Annual General Meeting on 26 April 2012 to reappoint PricewaterhouseCoopers as the Company's auditors and to authorise the Directors to agree their remuneration for the 2012 audit.

Political contributions

The Audit Committee is responsible for reviewing donations made for political purposes throughout the Group. No donation was made in 2011 to any political party registered in the UK under the Political Parties, Elections and Referendums Act 2000. Subsidiaries of the Company in Australia and Jamaica made contributions to non-EU political parties in their respective countries of incorporation totalling £209,104 (2010 £114,245).

Standards of Business Conduct

The Audit Committee is responsible for monitoring compliance with the Company's Standards of Business Conduct, which underpin the Group's commitment to good corporate behaviour. The Standards of Business Conduct require all staff to act with high standards of business integrity, comply with all applicable laws and regulations and ensure that business standards are never compromised for the sake of results. They were updated with effect from 1 September 2011 in order to ensure that they remain at the forefront of best business practice and to ensure alignment with the provisions of the UK Bribery Act 2010, which came into effect on 1 July 2011, and associated guidance.

Every Group company and every employee worldwide is expected to live up to the Standards of Business Conduct and guidance on them is provided across the Group, including through training and awareness programmes. All Group companies have adopted the Group Standards or local policies embodying them. They are applicable to all employees, including senior management, and to the Board Directors. Senior managers in the Group must report on annual compliance with the Standards with regard to all employees in the company or department for which they are responsible. Information on compliance with the Standards is gathered at a global level and reported to the regional audit and CSR committees and to the Audit Committee. The CSR Committee also reviews any Group reputation-related issues arising from non-compliance with the Standards.

The Standards of Business Conduct are available on www.bat.com

Confidential reporting procedures

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

Audit and accountability continued

Risk management and internal control

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, covering all material controls including financial, operational and compliance controls and risk management systems, and reports to shareholders that it has done so. During 2011, the Board reviewed the Group's risk profile, taking into account the implications of natural disasters, such as in Japan and Australia, and political upheaval, in particular in the Middle East and the Eurozone.

Overview

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

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

Audit and CSR committee framework

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

The Group's regional audit and CSR committees (which are all chaired by an Executive Director) focus on risks and the control environment within each region and are in turn supported by area and/or individual market audit and CSR committees. The corporate audit committee focuses on the risks and the control environment within the Group's operations which do not fall within the regional committees' remit, for example head office central functions, global programmes and above-region projects. It comprises members of the Management Board and is chaired by the Chief Executive.

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

Risk management and internal control processes

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 and 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 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 impact of changes in impact and likelihood, and the Audit Committee also spends time focusing on selected key risks in detail.

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

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

The results of these reviews are reported to the relevant regional audit and CSR committee or to the corporate audit committee and, where appropriate, to the Board's Audit Committee to ensure that appropriate remedial action has been, or will be, taken where necessary.

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

Financial reporting controls

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

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

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

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 current version of the Guidance applies to listed companies for financial years beginning on or after 1 January 2006.

The processes described above, and the reports that they give rise to, enable the Board and the Audit Committee to monitor the 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 its Audit Committee, has completed its annual review of the effectiveness of the system of risk management and internal control for the period since 1 January 2011. No significant failings or weaknesses were identified and the Board is satisfied that, where specific areas for improvement have been identified, processes are in place to ensure that the necessary remedial action is taken and that progress is monitored. The Board is satisfied that the system of risk management and internal control is in accordance with the Guidance.

Corporate social responsibility

Karen de Segundo
Chairman, CSR Committee

CSR Committee

Current members
Karen de Segundo (Chairman)
Ann Godbehere
Dr Gerry Murphy
Kieran Poynter

Attendance at meetings in 2011

Name	Meetings attended	Meetings eligible to attend
Karen de Segundo	4	4
Ann Godbehere ¹	1	1
Dr Ana Maria Llopis ²	2	2
Dr Gerry Murphy	4	4
Kieran Poynter	4	4

Notes

- Ann Godbehere became a member with effect from 24 October 2011
- Dr Ana Maria Llopis ceased to be a member of the Committee following her retirement as a Non-Executive Director at the conclusion of the Annual General Meeting on 28 April 2011

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

Summary Terms of Reference

The CSR Committee is responsible for:

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

The Committee's terms of reference were reviewed in December 2010 and minor updates were made with effect from 1 January 2011. The full terms of reference are available on www.bat.com

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

The Chairman of the Committee reports to the subsequent meeting of the Board on the Committee's work and the Board receives a copy of the minutes of each meeting. The papers considered by the Committee are available to any Director who is not a member, should they wish to receive them.

Key activities of the CSR Committee in 2011

The CSR Committee held four scheduled meetings in 2011, including a meeting held at the beginning of March to approve the Company's annual Sustainability Report. The other specific items considered by it included:

CSR governance

- Feedback and update reports from the regional audit and CSR committees and consideration of CSR-related internal audit reports and recommendations, including in relation to the organisation of the Group's approach to environmental, health and safety issues
- Following completion of the Control Navigator self-assessment exercise, an analysis of the results for the CSR controls and the action plans in place to achieve full compliance
- A review of the key reputational risks identified in the Group Risk Register, the potential impacts and consequences of such risks and the current controls in place to address them
- A continuing review of the potential reputational impact arising from incidents of non-compliance with the Standards of Business Conduct and a review and endorsement of the revised Standards of Business Conduct

CSR policies and compliance

- Potential risks in the countries where the Group does business which are of potential concern from a human rights perspective and the measures and controls in place to mitigate those risks
- Consideration of the measures in place within the Group directed towards eliminating child labour in tobacco growing, including its membership of the Eliminating Child Labour in Tobacco Foundation and its efforts to drive high standards from suppliers through its Social Responsibility in Tobacco Production (SRTP) programme

- Environmental, health and safety measures, including measures to improve safety culture behaviour throughout the Group and the recommendation for adoption by the Board of a revised Corporate Health and Safety Policy
- Adherence to the Group's International Marketing Standards and the recommendation for the adoption by the Board of specific Marketing Standards for Snus products
- The continuing work of the Biodiversity Partnership with three Non-Governmental Organisations – the Tropical Biology Association, Earthwatch and Fauna & Flora International – focusing on biodiversity in agricultural landscapes and the ecosystems on which they depend in key areas where the Group sources leaf
- Initiatives in the area of sustainable agriculture, with a focus on Brazil, including the development of an integrated supply chain and initiatives on reduction of agrochemical use and soil and water management
- Consideration of a review of the Group's approach to youth smoking prevention

Sustainability planning and reporting

- Central and local stakeholder dialogue activities during 2011
- A review of the 2010 Sustainability Report, including a summary of external feedback and proposed enhancements for 2011, and Ernst & Young's Assurance Management report
- An assessment of the 2011 goals and commitments for Sustainability reporting and progress made against the 2010 goals and commitments

During 2011, the Committee considered the feedback from the external Board evaluation exercise which took place in 2010, including a review of its standard agenda items, and reviewed and agreed its programme for 2012.

CSR governance

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

Statement of Business Principles

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

Sustainability reporting

The Company's Sustainability Reports and, prior to 2008, its Social Reports have detailed its social, ethical and environmental performance and performance against its commitments each year since the Company's first Social Report in 2002.

Corporate social responsibility continued

Sustainability reporting, like the social reporting that preceded it, is conducted using a robust methodology, including independent assurance conducted by Ernst & Young LLP, in line with the AA1000 Assurance Standard (2008). Engagement with key stakeholders is a major requirement of the Standard and we have continued to hold independently facilitated and assured dialogue with those stakeholders throughout the year.

The Company's sustainability reporting is based on its sustainability agenda, which was developed in 2007 and focuses on five pillars: harm reduction, marketplace, environment, supply chain and people and culture. Its aim is to create value for the Company's shareholders and wider society by addressing the Group's social, environmental and economic impacts.

Starting with the 2009 Report, produced in 2010, a single Sustainability Report has been produced for the Group, including balanced scorecards and case studies from some of the Group's largest markets. This approach, together with the information provided on www.bat.com, aims to provide comprehensive coverage of the Group's sustainability efforts globally.

In March 2011, the Company published its fourth Sustainability Report outlining progress in each of the five key elements of its sustainability agenda. In March 2012, it is publishing its fifth Sustainability Report, to coincide with publication of this Annual Report.

The Company has taken into account the increasing emphasis that is being placed on integrated financial and non-financial reporting. We believe that it is important to address sustainability issues in the Annual Report, but we also acknowledge that different audiences have differing expectations and requirements. As a result, we intend to continue publishing a separate Sustainability Report which covers in more detail progress against our sustainability agenda, including monitoring performance against targets. In addition to the Sustainability Report and the information provided in this Annual Report, the Company will continue to publish more detailed sustainability information on www.bat.com.

The Company has been included in both the Dow Jones Sustainability World Index (DJSI World) and the Dow Jones Sustainability Europe Index (DJSI Europe) for the tenth year running. These indices track the economic, environmental and social performance of companies that have demonstrated that they integrate sustainability into their business. In 2011, the Company received a gold rating in the UK's Business in the Community Corporate Responsibility Index, with a score of 94 per cent. The Company was also included in the STOXX® Global ESG Leaders Index, an innovative index that uses a transparent selection process to enable investors to fully understand which environmental, social and governance factors determine a company's rating. In addition, it won the top award for People Reporting in PricewaterhouseCooper's Building Public Trust Awards, the judges referring to the quality of people reporting in both the Annual Report, in the context of the Company's business strategy, and the Sustainability Report.

Corporate social investment

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

Group companies are encouraged to focus their CSI activities around three themes:

- **Sustainable agriculture and the environment** This includes activities such as efforts to improve biodiversity and access to water, afforestation, programmes to prevent child labour, grants for agricultural research and training to help farmers optimise land yields by growing additional (non-tobacco) crops. These initiatives are expected to complement the Group's own agricultural, environmental and biodiversity conservation practices.
- **Civic life** This encompasses activities that aim to enrich public and community life, including supporting the arts and educational institutions, conserving indigenous cultures and restoring public spaces.
- **Empowerment** This focuses on communities where we operate, providing people with educational opportunities to help them develop, for example through scholarships and information technology training or programmes supporting small businesses and promoting entrepreneurship. Group companies also continue to make other important contributions to meet local needs, such as relief efforts after natural disasters or programmes focused on HIV/AIDS.

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

Charitable contributions

Payments for charitable purposes in 2011 amounted to £13.7 million (2010: £15.5 million), £1.9 million of which was paid in the UK (2010: £2 million).

OECD Guidelines

The Group recognises its responsibilities to the countries in which it operates and in this context, notes the OECD Guidelines for Multinational Enterprises in their current form. 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 Report. Full details of a specific finding against our company in Malaysia under the Guidelines are provided in the full online report on www.bat.com.

Appointments to the Board

Richard Burrows
Chairman

Nominations Committee

Current members
Richard Burrows (Chairman)
Karen de Segundo
Ann Godbehere
Robert Lerwill
Christine Morin-Postel
Dr Gerry Murphy
Kieran Poynter
Anthony Ruys
Sir Nicholas Scheele

Attendance at meetings in 2011

Name	Meetings attended	Meetings eligible to attend
Richard Burrows	4	4
Sir Nicholas Scheele	3	4
Karen de Segundo	4	4
Ann Godbehere ¹	1	1
Robert Lerwill	4	4
Dr Ana Maria Llopis ²	2	2
Christine Morin-Postel	4	4
Dr Gerry Murphy	4	4
Kieran Poynter	4	4
Anthony Ruys	4	4

Notes

- Ann Godbehere became a member with effect from 24 October 2011
- Dr Ana Maria Llopis ceased to be a member of the Committee following her retirement as a Non-Executive Director at the conclusion of the Annual General Meeting on 28 April 2011

Sir Nicholas Scheele was unable to attend one meeting of the Nominations Committee due to a long-standing prior engagement.

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

Summary Terms of Reference

The Nominations Committee is responsible for

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

The Committee's terms of reference were reviewed in December 2010 and minor updates were made with effect from 1 January 2011. The full terms of reference are available on www.bat.com

The Nominations Committee is responsible for identifying candidates to fill vacancies on the Board. This process includes an evaluation of the skills and experience to be looked for in those candidates to ensure continuing Board balance. The selection process will generally involve interviews with a selection of candidates, using the services of external search firms specialising in board level recruitment to identify and shortlist appropriate candidates. This process was followed for the recruitment of Ann Godbehere, who was shortlisted by an external consultancy and interviewed by the Chairman and Executive Directors and by members of the Nominations Committee, which then recommended her appointment to the Board. The Committee and the Board specifically considered her other commitments and satisfied themselves that she was able to devote sufficient time to her role as a Non-Executive Director of the Company.

Further non-executive appointments remain under active consideration.

Appointments to the Board continued

Key activities of the Nominations Committee in 2011

The Nominations Committee held four meetings during 2011, two of which were scheduled and two of which were convened to address Main Board and Management Board succession issues. The specific items considered by the Committee included:

- The role specification for the appointment of additional Non-Executive Directors including, in particular, the skills required effectively to influence and provide constructive challenge
- Revised standard terms of appointment for Non-Executive Directors, updated to reflect the provisions of the UK Corporate Governance Code and to specify the expected time commitment for the induction process (see the section on information and professional development)
- The recruitment of Ann Godbehere and her appointment to the Board as a Non-Executive Director, with the assistance of an external recruitment consultancy, and the continuing search for a candidate with Asian experience
- The steps being taken to search for further potential non-executive appointments
- Changes in the composition of the Management Board, including
 - the appointment of Giovanni Giordano in the role of Group HR Director with effect from 1 June 2011,
 - the exchange of roles between Mark Cobben and Jack Bowles, with the appointment of Mark Cobben as Regional Director, Western Europe and of Jack Bowles as Regional Director, Americas,
 - the appointment to the Management Board of Kingsley Wheaton as Deputy Group Corporate & Regulatory Affairs Director with effect from 1 January 2012, to replace Michael Prideaux on his forthcoming retirement in June 2012, and
 - the creation of two new roles on the Management Board, namely Group Scientific Director and Business Development Director, and the appointment of Dr David O'Reilly and Naresh Sethi respectively in these roles with effect from 1 January 2012
- An overview of succession planning for the Executive Directors and members of the Management Board

During 2011, the Committee also considered a report prepared by the Company Secretary on its effectiveness, as assessed during the evaluation of the Board in 2010, including a review of its membership, frequency of meeting and regular terms of business.

Terms of appointment to the Board

The Executive Directors have rolling contracts of one year. The Non-Executive Directors do not have service contracts with the Company but instead have letters of appointment. Since 2010, all Non-Executive Directors have terms of appointment of one year only which are considered for renewal around the time of the Company's Annual General Meeting when, in accordance with the UK Corporate Governance Code, each Director is subject to election or re-election by the shareholders (see below). Details of the Company's policy on Executive Directors' service contracts and the terms of appointment for Non-Executive Directors are set out in the remuneration report.

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

Directors' interests and indemnities

Further details of Directors' contracts and letters of appointment, remuneration and emoluments, and their interests in the shares of the Company (including interests in share options and deferred shares) as at 31 December 2011 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 which they may incur in or about the execution of their duties to the Company or to any entity which is an associated company (as defined in Section 256 of the Companies Act 2006), or as a result of duties performed by the Directors on behalf of the Company or any such associated company.

Board diversity

The Board recognises the benefits of diversity in its widest sense, both at Board level and throughout all levels within the organisation. Diversity takes many forms: gender is one aspect, but other important attributes to consider will include, for example, nationality and background.

For a number of years, the Company has benefited from the presence on its Board of female Non-Executive Directors. During its search for additional Non-Executive Directors in 2011, culminating in the appointment of Ann Godbehere, the Company made clear to its external search consultancies that male-only shortlists of candidates would not be accepted. The current level of female representation on the Board stands at 25 per cent, the 2015 aspirational target level of female representation on Boards for FTSE 100 companies, as set out in the report by Lord Davies entitled *Women on Boards*. The Company hopes to at least maintain, and possibly to increase, this level of representation when refreshing and renewing Board membership over the coming years. However, such aspirations will always be subject to the overriding need to ensure that appointments are made on merit and having regard to an appropriate balance of skills, experience, independence and knowledge required on the Board. The Board will continue to take into account diversity, in all its forms, when making appointments.

Lord Davies's report also examines gender diversity at management levels below the Board. Whilst the Company has a number of initiatives to improve gender diversity at senior management levels, the Board recognises that these will take time to be reflected in the numbers of senior women in the Group. The recently appointed Group HR Director will be taking this forward in 2012.

The Board will continue to review and report further on the Company's approach to diversity and related ambitions, particularly in the context of any developing guidance in this area.

Annual General Meeting 2012

The Company will be submitting all eligible Directors for re-election or, in the case of Ann Godbehere, election for the first time at this year's Annual General Meeting on 26 April 2012.

Chairman

Richard Burrows

Executive Directors

Nicandro Durante (Chief Executive)

Ben Stevens (Finance Director and Chief Information Officer)

John Daly (Chief Operating Officer)

Non-Executive Directors

Karen de Segundo

Ann Godbehere

Robert Lerwill

Christine Morin-Postel

Gerry Murphy

Kieran Poynter

Anthony Ruys

Sir Nicholas Scheele

The Company's Articles of Association provide that any Director who has been appointed by the Board since the last Annual General Meeting is required to retire from the Board at the next Annual General Meeting and, being eligible, may offer himself or herself for reappointment. Accordingly, Ann Godbehere will retire and offer herself for reappointment in accordance with these provisions.

Non-Executive Directors who serve for a total of more than six years are subject to a particularly rigorous review. This was done in 2011 in the case of Robert Lerwill and Sir Nicholas Scheele, both of whom have served in excess of six years, and Anthony Ruys, who will have served in excess of six years at the time of the 2012 Annual General Meeting.

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

Remuneration report

Overview

As Chairman of the Remuneration Committee, I am very much aware that the last 12 months have seen increasing debate surrounding executive remuneration. The proposals announced by the Business Secretary in January 2012 which include increased transparency of reporting and more shareholder power to agree a company's future pay policy show just how far that debate has come. British American Tobacco has been active in contributing its views to that discussion. We responded to the consultation document issued by the Department for Business, Innovation and Skills on Executive Remuneration and on the linked consultation document on Narrative Reporting. We are broadly supportive of those proposals that aim to link pay to a company's performance and to increase transparency for shareholders. Indeed, we have for many years aimed to build a strong link between the Company's performance and the level of remuneration received by the Executive Directors and the senior management team. Our incentive schemes are designed to closely reflect the Group's key performance measures and we listen to shareholders on how our reporting may be improved.

It seems that others also believe we are on the right track. In November 2011 we were awarded the PricewaterhouseCoopers "Building Public Trust Award for FTSE 100 Executive Remuneration Reporting". I am clear that whilst the final details of the regulatory proposals on executive remuneration have yet to be determined, the Company is already relatively well placed to meet the Government's objectives.

Summary of key activities in 2011

Following on from the review undertaken by the Remuneration Committee in 2010, and the consultation with key shareholders at the end of that year and into 2011, last year our shareholders agreed to amend the Group's Long-Term Incentive Plan (LTIP). The new rules increased the maximum annual award under the LTIP scheme from 300 per cent to 400 per cent of annual base salary and also introduced a 'clawback' clause giving the Committee the discretion to reduce (or to 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.

We had also discussed with shareholders our desire to reduce the number of performance measures from six to four for the International Executive Incentive Scheme (IEIS) and at the suggestion of a number of shareholders we also increased the proportion of salary that Executive Directors are required to hold as shares under our shareholding guidelines.

These measures were all implemented in 2011 and I am confident that the revised reward structure for the Executive Directors and members of the Management Board further improves the alignment between remuneration and the delivery of the Group's strategy.

Anthony Ruys

Chairman, Remuneration Committee

We have for many years aimed to build a strong link between the Company's performance and the level of remuneration received by the Executive Directors and the senior management team.

Committee evaluation

During 2011, the Remuneration Committee also discussed the report on its own effectiveness, prepared following the 2010 Board evaluation, the key recommendation of which had been to review the size and composition of the Committee. Members of the Committee had a very fruitful discussion and while the creation of a smaller committee was considered, the current external profile of remuneration, generally, led them to believe that all Directors, at least for the time being, should be involved in remuneration issues. The Committee therefore continues to be made up of all independent Directors. Our discussions did however, lead to a number of significant changes for the Committee. These include at least one additional remuneration meeting being scheduled in 2012 as well as a revised agenda for each meeting and more regular discussions between shareholders and me over remuneration proposals. Full details of this review and its outcomes are set out elsewhere in this report. However, I am pleased that the Committee has looked in detail at the way in which it works and that we have some positive proposals to further improve our approach to executive remuneration and reporting.

Summary Terms of Reference

The Remuneration Committee is responsible for

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

The Committee's current terms of reference date from 1 January 2011 incorporating minor amendments made following a review in December 2010. The full terms of reference are available from the Company Secretary and on www.bat.com/governance

Remuneration Committee

Current members

Anthony Ruys (Chairman)
 Karen de Segundo
 Ann Godbehere²
 Robert Lerwill
 Christine Monn-Postel
 Dr Gerry Murphy
 Kieran Poynter³
 Sir Nicholas Scheele

Notes

- 1 Ana Maria Llopis ceased to be a member of the Remuneration Committee following her retirement as a Non-Executive Director at the conclusion of the Annual General Meeting on 28 April 2011
- 2 Ann Godbehere was appointed as a member of the Remuneration Committee with effect from 24 October 2011
- 3 Kieran Poynter was appointed as a member of the Remuneration Committee with effect from 25 October 2011

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

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

Attendance at meetings in 2011

Name	Meetings attended	Meetings eligible to attend
Anthony Ruys	5	5
Karen de Segundo	4	5
Ann Godbehere	2	2
Robert Lerwill	4	5
Ana Maria Llopis	2	3
Christine Monn-Postel	5	5
Gerry Murphy	5	5
Kieran Poynter	1	1
Sir Nicholas Scheele	3	5

Note

Those Directors who were absent from one or more meetings were either unable to attend a meeting arranged at short notice or had a long-standing prior engagement.

No Executive Director or Management Board member plays any part in determining his or her own remuneration. During the year ended 31 December 2011, both the Chief Executive and the Chairman were consulted and invited to attend meetings of the Committee, except when their own remuneration was under consideration. In determining remuneration for the year, the Committee considered reports from Deloitte LLP, the Committee's remuneration consultants, and also consulted the Chief Executive, the member of the Management Board responsible for Human Resources and the Group Head of Reward.

Remuneration report continued

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, and all employees are expected to cooperate with any request made by the Committee. The Committee is authorised by the Board to obtain, at the Company's expense, outside legal or other independent professional advice if it considers this necessary.

Deloitte LLP provided remuneration services and advice to the Remuneration Committee throughout the year at a cost of £101,800. Deloitte is an international professional services firm which, during the year, has also provided tax, corporate finance and consulting services to British American Tobacco Group companies around the world. Herbert Smith LLP has also been retained by the Company to provide legal advice in respect of the Company's share schemes, as well as providing other legal services to British American Tobacco as a whole. Ernst & Young LLP provides tax advice to international assignees and in respect of the Company's share schemes.

Evaluation of the Remuneration Committee

In October 2011, the Remuneration Committee discussed and considered the report on its effectiveness following the externally facilitated Board evaluation of 2010 with the following outcomes:

- **remuneration consultants** – it was confirmed that the remuneration consultants (Deloitte) performed well in providing external views and benchmarking information to the Remuneration Committee in a manner that was independent from the Company,
- **size of the committee** – it was recognised that the Committee was in the minority among comparable companies in having all or nearly all of its Non-Executive Directors as members of the Committee, however, the Committee concluded that, as these arrangements did not impair its effectiveness, and given the current external profile of remuneration issues, generally, that this membership profile of the Committee should continue for the time being,
- **number of meetings and agenda development** – in recognition of the increasing workload of the Committee it was agreed that the number of meetings of the Committee be increased from two to at least three scheduled meetings each year (to include private sessions without management present) and with an appropriately revised calendar of agenda items,
- **oversight** – it was agreed, following a trial at the meeting of the Committee in February 2011, to provide greater formality to the reporting of the appraisal process and associated outcomes for the Executive Directors and members of the Management Board, and
- **consultation process with institutional shareholders** – it was agreed that the Chairman of the Committee would seek regular meetings with institutional shareholders on remuneration matters irrespective of whether there might be any formal matters requiring shareholders' approval.

Key activities of the Remuneration Committee in 2011

The Remuneration Committee met five times during 2011. The Committee followed its regular work programme designed around its two scheduled meetings in February and October each year at which it:

- benchmarked, reviewed and set the salaries for the Executive Directors and the Management Board members taking into account the pay and employment conditions elsewhere in the Group, and particularly in the UK,
- assessed the achievement of the targets for the 2010 IEIS award and set the IEIS targets for 2011,
- assessed the measurement of the performance conditions for the vesting of the LTIP 2008 award,
- determined the LTIP awards for March 2011 (the general LTIP population) and May 2011 (Executive Directors and members of the Management Board) and their associated performance conditions,
- assessed the achievement of the targets for the 2010 Share Reward Scheme award and set the targets for the 2011 award,
- monitored the continued application of the Company's shareholding guidelines for the Executive Directors and the Management Board members,
- maintained oversight of the Group's salary review processes to ensure consistency of application, and
- reviewed the remuneration report for the year ended 2010 prior to its approval by the Board and subsequent approval by shareholders at the Annual General Meeting in April 2011.

In addition, the Remuneration Committee considered the following:

- feedback from the consultation with the Company's largest shareholders in connection with the proposed changes to the LTIP and IEIS prior to the recommendation of revised proposals to the Board in February 2011,
- changes to the Company's shareholding guidelines requiring an increase in the amount of shares to be held by the Executive Directors from 1 May 2011,
- the application of the Group's policy on returning expatriate employees in respect of John Daly's relocation from Hong Kong back to the UK in late 2010,
- the terms of appointment and termination in connection with Management Board appointments and departures during the year;
- the constituents of the Pay Comparator Group for the 2012 salary review and agreed to review the current criteria and constituent companies during 2012, for use in the 2013 salary review,
- a review of the report on the effectiveness of the Remuneration Committee as outlined above, and

- consideration of the impact of the tax treatment of UK pensions benefits for applicable Executive Directors and members of the Management Board following legislative changes

Remuneration policy: Group reward strategy

The Company adopts a straightforward approach to remuneration. The remuneration package comprises core fixed elements (base salary, pension and other benefits) as well as performance-based variable elements (a single cash and share incentive annual bonus plan (IEIS), and a single long-term incentive scheme (LTIP)) with the performance based elements forming approximately 60 per cent of the total remuneration package. These arrangements are very much 'plain vanilla' and it is rare that the Remuneration Committee is called upon to exercise its discretion.

Financially based Group key performance indicators (KPIs) form the basis for the majority of the performance-related bonus incentives with market share being an important additional non-financial indicator. The Executive Directors and the members of the Management Board are also held accountable for their performance in respect of the business measures which comprise a mixture of other financial and non-financial targets. Taken together, these elements provide a comprehensive set of challenging performance criteria which sit alongside the Company's positive position on sustainability and governance issues. Payouts and grants under the respective incentive schemes are directly linked to the Company's objectives, achieving a high level of alignment with the long-term interests of the Company and its shareholders.

The current Executive Directors' percentage of fixed and variable remuneration for 2011 is illustrated in the bar chart below. This is based on a number of assumptions: (1) base salary represents annual salary, (2) pension represents the annual service cost to the Company as calculated in accordance with IAS24 (Nicandro Durante's transfer value is based on constant exchange rates), (3) benefits are core benefits such as car allowance, private medical and personal accident insurance, (4) bonus is the amount received for performance in 2011 delivered in cash and deferred shares, and (5) LTIP represents the target annualised expected value of the long-term incentive award granted in 2011 expressed as a percentage of base salary. Fixed remuneration comprises salary, pension and benefits. Variable remuneration comprises bonus (cash and deferred shares) and LTIP.

Remuneration policy: risk management

The Company's strategy clearly underpins the remuneration policy for all employees. In particular, performance criteria for the IEIS are aligned to the Group's KPIs (see business review) with no individual performance objectives. Awards under the LTIP only vest to the extent that total shareholder returns and earnings per share have met appropriate thresholds. The design of the IEIS and its positioning as the Company's sole bonus scheme means that the risk of inappropriate individual behaviour to drive reward opportunities is minimised. The annual outcomes of the IEIS's four measures for performance are reviewed by the Group's external auditors and internal audit also provides a control framework (see audit and accountability in the corporate governance statement). The Remuneration Committee is therefore confident that there are clear processes in place to provide sufficient comfort that the Company only rewards true and verified performance.

Benchmarking of remuneration

The setting of remuneration for Executive Directors remains underpinned by responsible independent benchmarking. The approach is focused on a peer group which is made up of companies which meet the criteria of a consumer goods focus, an international spread of operations and a competitor for top management talent. It includes selected FTSE 100 companies and, the Group's key competitor, Philip Morris International (the Pay Comparator Group). This is supplemented by market data of listed companies of a similar size and complexity to the Company, as well as the practice of the FTSE 30 companies. The Pay Comparator Group as at 31 December 2011 is set out below.

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

The Remuneration Committee has agreed to review the constituents of the Pay Comparator Group during 2012, with any revisions to be implemented for the 2013 salary review.

Remuneration report continued

Salary

Purpose	<ul style="list-style-type: none"> – reward individual performance – reflect skills and experience
Delivery	<ul style="list-style-type: none"> – monthly – cash
Policy	<ul style="list-style-type: none"> – annual review in February (with salary changes effective from April) or ad hoc review on a significant change of responsibilities – benchmarked for appropriate salary levels using a company size and complexity model coupled with (1) the Pay Comparator Group, and, for Executive Directors, (2) published salary data of listed companies of a similar size and complexity to the Company – base salary is pensionable
2011 Update	– no change to policy

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

	Base salary from 1 April 2012 £	Base salary at 1 April 2011 £
Nicandro Durante (Chief Executive)	1,050,000	1,000,000
Ben Stevens (Finance Director and Chief Information Officer)	782,000	750,000
John Daly (Chief Operating Officer)	690,000	650,000

The Management Board members will receive salary increases averaging around 4.9 per cent, centre-based UK employees will receive salary increases averaging around 4.0 per cent in each case with effect from 1 April 2012. Actual rises have been based on each individual's contribution and performance and account is also taken of current UK market conditions to ensure that individual salaries are competitive.

In addition to basic salary, the Executive Directors receive certain benefits in kind, principally a car or car allowance, the use of a driver, the installation and then maintenance of home security systems, tax advice (where appropriate), and private medical and personal life and accident insurance. With the exception of the car or car allowance it is also the practice of the Company to pay the tax which may be due on any such benefits.

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

Purpose	– incentivise the attainment of corporate targets on an annual basis
Delivery	<ul style="list-style-type: none"> – annual award – 50 per cent cash – 50 per cent shares (deferred shares through the Deferred Share Bonus Scheme) – dividend equivalent payment
Policy	<ul style="list-style-type: none"> – four measures for performance for 2011 (reduced from six for 2010) with the following weightings: adjusted profit from operations (40 per cent), Group's share of key subsidiary markets (20 per cent), Global Drive Brand volume (20 per cent), and cash flow from operations (20 per cent) – the annual 'on-target' bonus opportunity for the Chief Executive is 100 per cent of base salary with a maximum award of 200 per cent of salary, and for the Chief Operating Officer and the Finance Director and Chief Information Officer the 'on-target' bonus opportunity is 90 per cent with a maximum award of 180 per cent – for the Management Board the 'on-target' bonus opportunity is 67.5 per cent of the base salary with a maximum award of 135 per cent of salary – awards are non-pensionable
2011 Update	<ul style="list-style-type: none"> – structure and potential bonus opportunity remain unchanged – introduction of four measures for performance for 2011 as above

The IEIS rewards short-term business performance within the context of longer-term sustainability. Appropriately stretching business and financial performance targets are set by the Remuneration Committee at the beginning of each year. The annual bonus opportunity for 2011 remained unchanged although the previous six measures were reduced to four with the applicable weightings as referred to above. These four performance measures provide a simplified and appropriate mix of criteria that look to assess the vitality and performance of the Company while still providing full clarity for both shareholders and eligible participants about the required areas of performance.

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

For senior managers only the total payouts reflect performance at a global, regional, area or end market level, as applicable to their roles. The annual bonus opportunity for senior managers remained unchanged in 2011 (with the exception of the alignment to four performance measures) with the annual 'on-target' bonus opportunity being 45 per cent of base salary with a normal maximum award of 90 per cent of salary rising to 135 per cent of base salary in cases of excellent performance. The award for senior managers continues to be delivered in variable proportions split between cash and deferred shares according to grade.

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

In respect of the year ended 31 December 2011, the performance against the measures and the total payouts under the IEIS were

IEIS measures of performance	Threshold	Between threshold and target	Target	Between target and maximum	Maximum
Performance in 2011					
four measures					
Adjusted profit from operations (40 per cent)					✓
Group's share of key subsidiary markets (20 per cent)					✓
Global Drive Brand volume (20 per cent)					✓
Cash flow from operations (20 per cent)					✓
Performance in 2010					
six measures					
Adjusted profit from operations (16.6 per cent)				✓	
Group's share of key subsidiary markets (16.6 per cent)					✓
Global Drive Brand volume (16.6 per cent)				✓	
Net revenue (16.6 per cent)		✓			
Cash flow from operations (16.6 per cent)					✓
Overheads and productivity savings (16.6 per cent)					✓

In respect of the year ended 31 December 2011, the total payouts under the IEIS are shown below. The actual performance-related payments are shown in Table 5 (annual cash bonus and deferred share bonus).

Payout	2011 %	2010 %
50 per cent in cash, 50 per cent in deferred shares		
Nicandro Durante (Chief Executive)	200.0	156.5
Ben Stevens (Finance Director and Chief Information Officer)	180.0	156.5
John Daly (Chief Operating Officer)	180.0	156.5
Management Board members	135.0	117.4

Paul Adams retired as Chief Executive on 28 February 2011 and ceased 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 first two months of the year ended 31 December 2011 is pro-rated as an 'on-target' amount payable as a 100 per cent cash bonus instead of 50 per cent in cash and 50 per cent in deferred shares.

For senior managers whose bonus was linked to global performance the total payout under the IEIS in respect of the year ended 31 December 2011 was 135 per cent (2010 96.9 per cent), paid 94.5 per cent in cash and 40.5 per cent in deferred shares.

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

Remuneration report continued

Long-term incentives

Purpose	– incentivise growth in earnings per share and total shareholder return (TSR) over a three year period
Delivery	– discretionary annual award – awards of shares – variable due to performance over three year period – dividend equivalent payment
Policy	– maximum annual award of 400 per cent of salary – three year performance period – TSR performance (50 per cent of the total award) combines both the share price and dividend performance during the three year performance period as against two comparator groups (25 per cent for each measure) (1) constituents of the FTSE 100 Index, and (2) a peer group of FMCG companies – earnings per share measure (50 per cent of the total award) relates to earnings per share growth (on an adjusted diluted basis) relative to inflation
2011 Update	– shareholders approved an increase in the maximum annual award under the LTIP scheme rules from 300 per cent to 400 per cent of annual base salary – LTIP awards made in May 2011 were made at 400 per cent of annual base salary for the Chief Executive and at 300 per cent for the other Executive Directors – the introduction of a discretionary power to reduce/forfeit unvested awards in the event of material misrepresentation – all other elements of the LTIP remain unchanged

The long-term element of remuneration continues to be delivered through the Company's LTIP. All the Executive Directors, Management Board members and senior employees participate in the Long-Term Incentive Plan adopted in 2007 (the 2007 LTIP) – the successor plan to the 1998 LTIP. The 2007 LTIP provides for awards of free ordinary shares, provided demanding and appropriately stretching performance conditions are met over a three year period.

Award levels

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

	Multiple of base salary % 2011	Multiple of base salary % 2010
LTIP awards		
Chief Executive	400	300
Finance Director and Chief Information Officer	300	250
Chief Operating Officer	300	250
Management Board	200	200

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

Following assessment by the Remuneration Committee, LTIP awards may only be normally exercisable after three years to the extent that the performance conditions are satisfied in accordance with the measures set out above at the end of the three year performance period. Any proportion of an award that lapses does not attract the payment of the LTIP dividend equivalent payment.

Performance

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

TSR performance condition

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

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

The applicable FMCG peer groups for the outstanding LTIP awards as at 31 December 2011 are shown below

FMCG peer group	Award 13 May 2011 (Vesting date 13 May 2014)	Award 25 March 2010 (Vesting date 25 March 2013)	Award 27 March 2009 (Vesting date 27 March 2012)
Anheuser-Busch InBev	✓	✓	✓
Cadbury			✓
Campbell Soup	✓	✓	✓
Carlsberg	✓	✓	✓
Coca-Cola	✓	✓	✓
Colgate-Palmolive	✓	✓	✓
Danone	✓	✓	✓
Diageo	✓	✓	✓
Heineken	✓	✓	✓
HJ Heinz	✓	✓	✓
Imperial Tobacco Group	✓	✓	✓
Japan Tobacco	✓	✓	✓
Johnson & Johnson	✓	✓	✓
Kellogg	✓	✓	✓
Kimberly-Clark	✓	✓	✓
Kraft Foods	✓	✓	
LVMH	✓	✓	✓
Nestlé	✓	✓	✓
PepsiCo	✓	✓	✓
Pernod Ricard	✓	✓	✓
Philip Morris International	✓	✓	✓
Procter & Gamble	✓	✓	✓
Reckitt Benckiser	✓	✓	✓
SABMiller	✓	✓	✓
Sara Lee	✓	✓	✓
Unilever	✓	✓	✓

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

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

EPS performance condition

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

These EPS targets are consistent with and support the Company's strategy to deliver high single-digit EPS growth (on average) over the medium to long term. The Remuneration Committee reviewed the EPS targets as part of its review of long-term incentives in 2010 and the consultation with key shareholders at the end of 2010 and early 2011. It concluded that the current targets continue to be appropriately stretching.

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

Since the LTIP award made in March 2009, EPS performance is measured as an increase in adjusted diluted EPS between the base year and the final year of the performance period, expressed as an annual growth rate over the period. Under this approach, only the base year and final year adjusted diluted EPS results are considered. However, on the basis that rolling annual awards are made, all years of performance ultimately will be taken into account in calculating EPS growth over time. This change was made in order to simplify the approach and to bring it into line with prevailing market practice. Where EPS grows at a relatively constant rate, the two methodologies will produce broadly similar results, although the outcome will differ for different growth profiles. Both methods are considered to be fair and reasonable measures of performance.

Vesting of LTIP award made in 2009

An LTIP award was made to Executive Directors and Management Board members on 27 March 2009 with the performance period being completed at 31 December 2011 (the 2009 Award). The Remuneration Committee has assessed the performance of the Company against the two performance conditions. On the TSR measure, the Company ranked 21st out of the FTSE 100 group of companies, giving a vesting of 25 per cent for performance at the upper quartile. A vesting of 25 per cent was also achieved for ranking 5th out of the peer group of international FMCG companies, this also being upper quartile. EPS growth was 10.8 per cent per annum in excess of inflation. The overall assessment of both LTIP measures, therefore, resulted in a vesting of 100 per cent of the award.

Remuneration report continued

In accordance with the rules of the 2007 LTIP, the Remuneration Committee also resolved that the participants would receive an LTIP dividend equivalent payment on the vesting of their 2009 awards

The following table shows the vesting of the award made in 2009 in the context of the performance of LTIP awards vesting during the years ended 31 December 2009 to 31 December 2011, inclusive

Long-Term Incentive Plan Vesting of Past Awards Years Ended 2009 to 2011

LTIP award date	27-Mar-09	15-May-08	15-May-07
Year ended	31-Dec-11	31-Dec-10	31-Dec-09
Performance period	2009/2011	2008/2010	2007/2009
Vesting date	27-Mar-12	15-May-11	15-May-10

TSR – FTSE 100 group of companies

Ranking – upper quartile	21	12	8
Percentage of vesting award	25	25	25

TSR – FMCG peer group

Ranking – upper quartile	5	2	2
Percentage of vesting award	25	25	25

Earnings per share growth

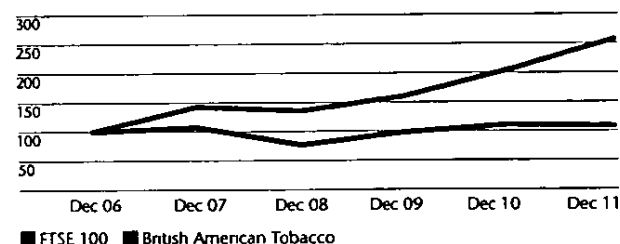
Percentage per annum above inflation	10.8	15.9	12.1
Percentage of vesting award	50	50	50

Total vesting percentage	100	100	100
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Performance graph

Schedule 8 to the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 requires that the Company must provide a graph comparing the TSR performance of a hypothetical holding of shares in the Company with a broad equity market index over a five year period. In this context, the Directors have again chosen to illustrate the performance of TSR against the FTSE 100 Index over a five year period, commencing on 1 January 2007. In the opinion of the Directors, the FTSE 100 Index is the most appropriate index against which TSR should be measured because it is a widely used and understood index of broadly similar sized UK companies to the Company. The performance graph is shown on this page.

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



Total shareholder return (annual %)

FTSE 100 – 1 January 2009 to 31 December 2011

The FTSE 100 comparison is based on three months' average values

Total shareholder return (annual %)

FMCG group – 1 January 2009 to 31 December 2011

The FMCG group comparison is based on three months' average values

LTIPs – 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.

All-Employee Share Scheme

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

Sharesave Scheme

The Sharesave Scheme is approved by HM Revenue & Customs (HMRC). Eligible employees, including the Executive Directors and Management Board members, have been granted employee savings-related share options to subscribe for ordinary shares in the Company. Following a review of its timetable for making grants of options under the Sharesave Scheme, the Company has, since March 2011, introduced a practice of making grants of options under the Sharesave Scheme at that time each year following its Preliminary Announcement. Options are granted to be exercisable in conjunction with either a three year or five year savings contract up to a monthly limit of £250. Options are normally granted at a discount of 20 per cent to the market price at the time of the invitation, as permitted under the rules of the Sharesave Scheme. At 31 December 2011, Nicandro Durante and Ben Stevens each held options under the Sharesave Scheme.

Employee Share Ownership Plan

The Employee Share Ownership Plan is an HMRC-approved share incentive plan, which incorporates a Partnership and Free Shares element. The Partnership Share Scheme is open to all eligible employees, including Executive Directors and Management Board members. Employees can allocate part of their pre-tax salary to purchase shares in the Company. The maximum amount that can be allocated in this way is £1,500 in any year. Shares purchased are held in a UK-based trust, normally capable of transfer to participants tax-free after a five year holding period. At 31 December 2011, Nicandro Durante participated in the Partnership Share Scheme.

The Company also operates the Free Shares element of the plan, known as the Share Reward Scheme. Under this Scheme, eligible employees (including Executive Directors and members of the Management Board) receive an award of shares in April of each year in which the Scheme operates in respect of performance in the previous financial year. An award of £3,000 will be made to Executive Directors and Management Board members on 2 April 2012 in respect of the year ended 31 December 2011. The performance conditions are aligned to those set for the IES in respect of the same performance period. The plan shares are held in a UK-based trust for a minimum period of three years and during that time the trust will exercise its voting rights as directed by the plan's participants. The maximum individual award under the Share Reward Scheme is £3,000.

Options and awards outstanding

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

During the year, new ordinary shares were issued by the Company in relation to the Sharesave Scheme and to certain participants in the Share Option Scheme resident outside the UK.

Under the Sharesave Scheme, a total of 881,940 options over ordinary shares in the Company were outstanding at 31 December 2011. The options outstanding under the Sharesave Scheme are exercisable until September 2016 at option prices ranging from 1,152p to 1,974p.

The British American Tobacco Group Employee Trust (BATGET)

BATGET is used to satisfy the vesting and exercise of awards of ordinary shares made under the Deferred Share Bonus Scheme, and the 1998 LTIP and the 2007 LTIP as well as the exercise of options under the Share Option Scheme. The number of shares held in BATGET to satisfy outstanding awards is consistently monitored by a committee of senior management that reports to the Board's Employee Share Schemes Committee. BATGET is funded by interest-free loan facilities from the Company totalling £600 million, enabling the trust to facilitate the purchase of ordinary shares to satisfy the future vesting or exercise of options and awards. The loan to BATGET amounted to £424 million at 31 December 2011 (2010: £325 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.

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

	1 January 2011	31 December 2011
Number of ordinary shares	11,949,088	12,123,853
Market value of ordinary shares	£294.4m	£370.4m
Percentage of the issued share capital of the Company	0.59	0.59

BATGET currently waives dividends on the ordinary shares held by it. BATGET waived payment of the final dividend for 2010 of £9.0 million in May 2011 and the interim dividend for 2011 of £4.8 million in September 2011.

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

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

Remuneration report continued

Shareholding guidelines

The Remuneration Committee's guidelines require Executive Directors to hold shares in the Company equal to the value of a percentage of salary as set out below and excludes shares earned but not yet vested under Company share plans. Management Board members are also required to hold shares in the Company equal to the value of 100 per cent of their salary.

Shareholding guidelines	Required multiple of base salary % (since 1 May 2011)	Required multiple of base salary % (up to 1 May 2011)	Actual multiple of base salary % at 31 December 2011
Nicandro Durante (Chief Executive)	300	200	455
Ben Stevens (Finance Director and Chief Information Officer)	200	150	233
John Daly (Chief Operating Officer)	200	150	170

John Daly, who was appointed an Executive Director and Chief Operating Officer on 1 September 2010, is currently subject to the transitional provisions in place for those Executive Directors and Management Board members who do not meet the requirements of the shareholding guidelines upon appointment. In such cases, individuals may, generally, only sell a maximum of up to 50 per cent of any shares vesting (after tax) under Company share plans until the threshold under the shareholding guidelines has been met.

The interests of the Directors of the Company in the ordinary shares of the Company are shown in Table 6.

Executive Directors' pension benefits

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

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

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

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

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

John Daly and Ben Stevens each joined the Pension Fund after 1989. As a result, prior to 6 April 2006, these individuals were subject to the HM Revenue & Customs cap on pensionable earnings (notionally £129,000 for the tax year 2011/12). 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 and Ben Stevens has, with member consent, been restricted to the statutory annual allowance of £50,000 per annum with the balance of approximately £1,840 per annum being provided through the UURBS. 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 cent per annum.

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 €107,479 per annum, payable from the age of 60. This benefit is scheduled to increase each year between January 2011 and December 2015 by the lower of 4 per cent or the Irish Consumer Price Index. The increase amount is confirmed each year by the Minister of Social Protection in Ireland (the increase for 2011 was 1.75 per cent).

Paul Adams retired as an Executive Director on 28 February 2011. Details of his pension entitlements are set out in note 6 to Table 8.

Nicandro Durante is a member of the Fundação Albino Souza Cruz (FASC) in Brazil. This is a non-contributory defined benefit scheme and includes a spouse's death in service benefit equal to 37.5 per cent of the member's prospective pension at normal retirement age. Accrual rates do not exceed 1.85 per cent of basic salary (excluding bonus) averaged over the 12 months to normal retirement age, for each year of pensionable service. Nicandro Durante's Brazilian pensionable salary will be reviewed by the Company annually with reference to the salary of that of a General Manager of Souza Cruz SA which will be adjusted annually in line with local practice and agreed with the Company. Benefits from the FASC remain subject to the rules of that scheme.

In addition, Nicandro Durante accrues a pension of 0.65 per cent for each year of service (the UK Accrual Rate) with effect from 1 March 2006, being the date of his appointment as a member of the Management Board. At retirement the pension will be based on Nicandro Durante's 12 month average UK base salary (excluding bonus) immediately prior to retirement. This accrued pension will be provided through the UURBS.

Further, with effect from 1 January 2011, the UK Accrual Rate for the element of the base salary in excess of £670,000 increased from 0.65 per cent as stated above to 2.50 per cent for each year of service and will continue to be provided through the UURBS. The initial base salary level of £670,000 in respect of the 2.50 per cent accrual provided through the UURBS will be adjusted annually by the same percentage as that agreed for Nicandro Durante's pensionable salary for the purposes of calculating benefits payable from the FASC. Following legislative changes to the applicable UK tax relief regulations in respect of members of overseas pension arrangements, Nicandro Durante has elected to commence the receipt of his benefits from the FASC in Brazil with effect from 1 April 2012. The resulting tax charge for the period from 1 April 2011 to 31 March 2012 will be tax equalised by way of a payment to Nicandro Durante of an allowance. No further compensation will be made or element of remuneration adjusted in lieu of further pension accrual in the FASC.

Executive Directors' service contracts

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

The Remuneration Committee, however, has discretion to agree longer contracts in the event that an Executive Director is recruited externally or from overseas, when it may then be appropriate to offer a contract with an initial period of longer than one year, reducing to a one year rolling contract after the expiry of the initial period. None of the current Executive Directors falls within this type of contract.

An Executive Director's compensation payment, in lieu of notice, would comprise (1) 12 months' salary at his then current base pay, and (2) a cash payment in respect of other benefits under the contract such as medical insurance, or the Company may at its option continue those benefits for a 12 month period. The Committee maintains discretion as to how to deal with any grants or awards made prior to termination under the LTIPs and the IEIS. Pension entitlements are dealt with in accordance with the terms and conditions of the applicable pension scheme and do not form part of the contractual compensation payment.

The compensation payment is payable where the requisite 12 months' notice is not given to the Executive Director or when he terminates by giving 12 months' notice and the Company does not wish him to serve his notice. If a period of notice is served, the compensation payment is reduced pro rata. In the unlikely event that the contract is terminated for cause (such as gross misconduct), the Company may terminate the contract with immediate effect and no compensation would be payable.

Nicandro Durante has a service contract with the Company in the form outlined above. In addition, as a result of the application of local labour laws in Brazil, Nicandro Durante retains certain termination or compensation rights in respect of his former employment with Souza Cruz SA. In the event of any compensation being payable to Nicandro Durante pursuant to his service contract with the Company, these Souza Cruz rights will be taken into account first in arriving at a final compensation amount in order that he does not benefit twice from these dual arrangements.

Executive Director	Execution date of current service contract	Date first appointed to the Board	Date of last reappointment at AGM	Length of service as an Executive Director as at 2012 AGM (Years/Months)
Nicandro Durante	10 December 2010	1 January 2008	28 April 2011	4.4
Ben Stevens	26 March 2008	3 March 2008	28 April 2011	4.2
John Daly	24 October 2010	1 September 2010	28 April 2011	1.8

Remuneration report continued

Executive Directors' external appointments

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

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

John Daly, an Executive Director of the Company, has been a non-executive director of Reynolds American Inc (RAI) since 1 December 2010. RAI is an associate undertaking of the Company and John Daly was designated by Brown & Williamson Holdings, Inc (a wholly-owned indirect subsidiary of the Company), as its nominee to sit on the board of RAI. In accordance with present arrangements, the Group received a fee of US\$237,000 from RAI (2010: US\$195,525) in respect of John Daly's service in that role for the year ended 31 December 2011.

Non-Executive Directors' terms of appointment

The Non-Executive Directors do not have service contracts with the Company but instead have letters of appointment. Since 2010 and following 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 Annual General Meeting. Each Director is then subject to election or re-election by shareholders every year.

The date of appointment, the most recent reappointment and length of service for each Non-Executive Director are shown in the table below

Non-Executive Director	Date of appointment	Date of last reappointment at AGM	Length of service as at 2012 AGM (Years/Months)
Karen de Segundo	1 October 2007	28 April 2011	4 7
Ann Godbehere	3 October 2011	–	0 7
Robert Lerwill	1 January 2005	28 April 2011	7 4
Christine Morin-Postel	1 October 2007	28 April 2011	4 7
Gerry Murphy	13 March 2009	28 April 2011	3 1
Kieran Poynter	1 July 2010	28 April 2011	1 10
Anthony Ruys	1 March 2006	28 April 2011	6 2
Sir Nicholas Scheele	28 February 2005	28 April 2011	7 2

On termination, at any time, a Non-Executive Director is entitled to any accrued but unpaid Director's fees but not to any other compensation

Non-Executive Directors' remuneration policy

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

	With effect from 1 Jan 2012 £	Jan-Dec 2011 £
Basic fee	90,000	90,000
Supplements		
– Senior Independent Director	28,000	28,000
– Audit Committee Chairman	28,000	28,000
– CSR Committee Chairman	23,000	23,000
– Nominations Committee Chairman	–	–
– Remuneration Committee Chairman	28,000	23,000
Committee Membership Fees (not Chairmen)		
– Audit Committee	5,000	5,000
– CSR Committee	5,000	5,000
– Nominations Committee	–	–
– Remuneration Committee	5,000	–

The fees for the Non-Executive Directors are considered annually and are determined in light of market best practice and with reference to the time commitment and responsibilities associated with the roles

In October 2011, in order to recognise the increasing focus on remuneration matters and the corresponding increase in the workload of the Remuneration Committee, the supplement for chairing that Committee was increased to £28,000 and a Committee membership fee of £5,000 per annum was introduced for Non-Executive Directors who are members of the Remuneration Committee

The basic fee and other supplements and Committee membership fees for Non-Executive Directors remain unchanged

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

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, the Company will meet, as appropriate, the personal income tax liability that arises. They receive no other

Remuneration report continued

pay or benefits. It is the policy of the Board that the spouses of the Executive Directors and Non-Executive Directors may accompany the Directors for business purposes on designated trips and functions during the year.

Anthony Ruys 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 2011, Anthony Ruys received INR 720,000 (£8,724) in fees from ITC (2010 INR 680,000 (£9,713)). This amount is the subject of an annual supplement from a Group company so that he receives a total annual fee for this appointment of £75,000. Anthony Ruys also has an interest in options over shares in ITC – see Table 9.

Chairman's terms of appointment and remuneration

The Remuneration Committee is responsible for determining the terms of engagement and fees payable to the Chairman. This process takes into account the breadth of that role coupled with its associated levels of commitment and expertise.

Richard Burrows has been a Director of the Company since 1 September 2009 and has been Chairman of the Company from 1 November 2009. Since September 2011, Richard Burrows has a term of appointment of one year only which is considered for renewal around the time of the Company's Annual General Meeting each year unless the appointment is terminated earlier by (1) the Company giving three months' notice or a discretionary compensation payment in lieu of notice, or (2) by him giving one month's written notice, with the Company having discretion to make a compensation payment in lieu of such notice. The compensation payment is limited to any fees which are payable for such part of the relevant notice period as the Board does not require him as Chairman to perform his duties.

The current terms of Richard Burrows' appointment provide for (1) an annual fee of £570,000, (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 Ireland in connection with his duties as Chairman. In common with the Non-Executive Directors, Richard Burrows does not participate in the British American Tobacco share schemes, bonus schemes or incentive plans and is not a member of any Group pension plan.

In February 2012, the Remuneration Committee reviewed the fees for the Chairman against practice in the FTSE 30 and agreed to increase his annual fees from £570,000 to £600,000 with effect from 1 April 2012.

Copies of service contracts and terms of appointment

Copies of the Executive Directors' service contracts and the details of the terms of appointment of each Non-Executive Director and the Chairman are available for inspection during normal business hours at the Company's registered office and will also be available for inspection at the Annual General Meeting on 26 April 2012.

Appendices to the remuneration report

Table 1 Aggregate emoluments – audited

The emoluments of the Directors of British American Tobacco plc were as follows

	2011 £	2010 £
Salaries and fees	3,732,000	4,094,584
Benefits – cash and non-cash	868,923	1,239,126 ¹
Performance-related pay		
– cash bonus	2,260,000	3,500,527
– deferred share bonus	2,260,000	1,257,217
– DSBS and LTIP equivalents	578,618	701,947
– Share Reward Scheme	7,767	6,084
Former Directors	1,051,593	43,602
Total	10,758,901	10,843,087

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

Notes

1 2010 benefits (£1,214,506) restated – see Table 2 (Note 1) and Table 3 (Note 1)

Appendices to the remuneration report continued

Table 2. Fees of the Chairman – audited

Richard Burrows

	2011 Fees £	2011 Benefits £	2011 Total £	2010 Fees £	2010 Benefits £	2010 Total £
Total	558,750	112,673²	671,423	525,000	168,363¹	693,363

Notes

- 1 Richard Burrows 2010 benefits of £157,319 are restated to take account of the change in the Company's reporting of hotel accommodation and related expenses in respect of Directors' attendance at Board meetings of the Company in the UK in respect of which UK tax is payable
- 2 Richard Burrows 2011 benefits comprise (1) health insurance (£12,643), (2) the use of a company driver (£50,050), (3) maintenance of home security systems (£8,939), and (4) hotel accommodation and related expenses incurred in connection with individual and/or accompanied attendance at certain business functions and/or corporate events

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

	2011						2010				
	Board fees £	Senior Independent Director £	Audit Committee £	Remuneration Committee ³ £	CSR Committee £	Fees £	Benefits £	Total £	Fees £	Benefits £	Total £
Karen de Segundo ^{2,3}	90,000				23,000	113,000	1,192	114,192	110,000	16,399	126,399
Ann Godbehere ² (from 3 October 2011)	22,500				1,250	23,750		23,750			
Robert Lerwill ³	90,000		28,000			118,000	3,550	121,550	115,000	3,447 ^(a)	118,447
Christine Monn-Postel	90,000		5,000			95,000	920	95,920	90,000	1,723 ^(b)	91,723
Gerry Murphy ³	90,000				5,000	95,000	1,154	96,154	90,000	8,103	98,103
Kieran Poynter ³ (from 1 July 2010)	90,000				5,000	95,000	105	95,105	45,000	118	45,118
Anthony Ruys ^{3,4}	90,000		5,000	23,000		118,000	7,464	125,464	110,000	8,923 ^(c)	118,923
Sir Nicholas Scheele ^{2,3}	90,000	28,000	5,000			123,000	29,687	152,687	115,000	20,433 ^(e)	135,433
Former Non-Executive Director											
Ana Mana Llopis (until 28 April 2011)	30,000				1,667	31,667	2,253	33,920	90,000	1,498 ^(a)	91,498
Total	682,500	28,000	43,000	23,000	35,917	812,417	46,325	858,742	765,000	60,644¹	825,644

Notes

- 1 The total benefits in respect of 2010 have been restated in the table above (2010: £47,068) to take account of the change in the Company's reporting of hotel accommodation and related expenses in respect of Directors' attendance at Board meetings of the Company in the UK in respect of which UK tax is payable. This change affected a number but not all of the Directors. Those Directors whose numbers are restated above are the following: (a) Robert Lerwill (2010: £774), (b) Christine Monn-Postel (2010: £0), (c) Anthony Ruys (2010: £5,543), (d) Sir Nicholas Scheele (2010: £16,131), and (e) Ana Mana Llopis (2010: £0)
- 2 The total benefits shown for these Directors exclude the reimbursement of travel expenses (air, rail and taxi fares) in respect of Directors' attendance at Board meetings of the Company in the UK in respect of which UK tax is payable. The gross amounts of the travel costs and the tax which is due thereon is 2011: £102,706, and 2010: £69,298
- 3 Benefits for these Non-Executive Directors include those expenses incurred in connection with accompanied attendance at business functions
- 4 In addition, Anthony Ruys received INR 720,000 (£8,724) (2010: INR 680,000 (£9,713)) from ITC Limited, the Group's associate undertaking in India in respect of his services as a Non-Executive Director of that company during 2011. This was supplemented by a further payment of £66,276 (2010: £65,287) paid by the Group for services up to and including 31 December 2011
- 5 During 2011 no fees were payable to members of the Remuneration Committee, only the Committee Chairman received a fee. From 1 January 2012, £5,000 per annum will be paid to Remuneration Committee members. No fees are paid in respect of membership of the Nominations Committee

Table 4 Summary of individual emoluments of Executive Directors – audited

	Salary £	Benefits £	Performance- related pay £	Total 2011 £	2010 £
Nicandro Durante	1,000,000	338,863	2,259,662	3,598,525	2,408,386
Ben Stevens	742,500	107,489	1,542,747	2,392,736	2,011,236
John Daly (from 1 September 2010)	650,000	265,826	1,303,976	2,219,802	725,644
Total	2,392,500	712,178	5,106,385	8,211,063	5,145,266

Former Executive Directors

	Salary £	Benefits £	Performance- related pay £	Total 2011 £	2010 £
Paul Adams (until 28 February 2011)	215,000	31,076 ²	771,597 ³	1,017,673	4,135,212
Antonio Monteiro de Castro (until 31 December 2007)	–	–	–	–	8,401
Paul Rayner (until 30 April 2008)	–	–	–	–	35,201
Total	215,000	31,076	771,597	1,017,673	4,178,814

Notes

- The Executive Directors' remuneration shown above does not include, in respect of the LTIP awards made in March 2009 and which will vest on 27 March 2012 (1) the illustrative values of those awards as at 21 February 2012 (reference should be made to the illustrative values shown for each Executive Director in Table 7), and (2) the values of the LTIP dividend equivalent payments to be made in respect of those awards which are Nicandro Durante £323,176, Ben Stevens £301,631, and John Daly £176,669
- Paul Adams benefits comprise (1) a car allowance (£2,640), (2) health insurance (£504), (3) the use of a company driver (£11,925), (4) maintenance of home security systems (£409), and (5) a retirement gift and other expenses incurred in connection with individual and/or accompanied attendance at certain business functions and/or corporate events
- Paul Adams performance related pay comprises (1) £556,597 as the LTIP dividend equivalent payment for the LTIP awards which vested at his retirement, in full and/or on a pro-rated time and performance basis in accordance with the LTIP rules, and (2) £215,000 as an 'on-target' pro-rated cash bonus for the period from 1 January 2011 until the date of his retirement on 28 February 2011 in accordance with the rules of the IEIS

Table 5 Analysis of remuneration of Executive Directors – audited

Nicandro Durante

	2011 £		2010 £
Salary	1,000,000	Salary	660,000
Benefits cash ¹	15,840	Benefits cash	13,560
Benefits non-cash ²	323,023	Benefits non-cash	573,369
Annual cash bonus	1,000,000	Annual cash bonus	524,275
Value of deferred share bonus	1,000,000	Value of deferred share bonus	524,275
Cash dividend equivalent (DSBS) ³	34,136	Cash dividend equivalent (DSBS)	25,046
Cash dividend equivalent (LTIP) ³	222,937	Cash dividend equivalent (LTIP)	85,833
Share Reward Scheme value of shares received during the year	2,589	Share Reward Scheme value of shares received during the year	2,028
Total – see Table 4	3,598,525	Total – see Table 4	2,408,386

Notes

- Cash benefits comprise a car allowance (£15,840)
- Non-cash benefits comprise (1) life and health insurance (£14,139), (2) tax advice (£49,340), (3) the use of a company driver (£63,633), (4) travel and related costs in respect of the relocation of Nicandro Durante from Brazil (£142,686), (5) employee welfare and medical payments made by Souza Cruz SA in respect of Nicandro Durante's subsisting employment rights in Brazil (£36,202), (6) maintenance of home security systems in the UK and Brazil (£10,013); and (7) other expenses incurred in connection with individual and/or accompanied attendance at certain business functions and/or corporate events
- Cash dividend equivalent payments (1) DSBS – these are cash sums equivalent to the dividend on the after-tax position on all unvested ordinary shares comprised in the share awards held by participants in the DSBS at each dividend record date, and (2) LTIP – this is a cash sum equivalent to the dividends that an LTIP participant would have received as a shareholder on the actual number of shares under an LTIP award

Appendices to the remuneration report continued

Table 5 Analysis of remuneration of Executive Directors – audited continued

Ben Stevens

	2011 £		2010 £
Salary	742,500	Salary	654,167
Benefits cash ¹	13,560	Benefits cash	13,560
Benefits non-cash ²	93,929	Benefits non-cash	95,095
Annual cash bonus	675,000	Annual cash bonus	563,400
Value of deferred share bonus	675,000	Value of deferred share bonus	563,400
Cash dividend equivalent (DSBS) ³	32,245	Cash dividend equivalent (DSBS)	24,215
Cash dividend equivalent (LTIP) ³	157,913	Cash dividend equivalent (LTIP)	95,371
Share Reward Scheme value of shares received during the year	2,589	Share Reward Scheme value of shares received during the year	2,028
Total – see Table 4	2,392,736	Total – see Table 4	2,011,236

Notes

- Cash benefits comprise a car allowance (£13,560)
- Non-cash benefits comprise (1) life and health insurance (£7,030), (2) the use of a company driver (£75,838), (3) maintenance of home security systems (£2,761), and (4) other expenses incurred in connection with individual and/or accompanied attendance at business functions and/or corporate events
- Cash dividend equivalent payments (1) DSBS – these are cash sums equivalent to the dividend on the after-tax position on all unvested ordinary shares comprised in the share awards held by participants in the DSBS at each dividend record date, and (2) LTIP – this is a cash sum equivalent to the dividends that an LTIP participant would have received as a shareholder on the actual number of shares under an LTIP award

John Daly

(from 1 September 2010)

	2011 £		2010 £
Salary	650,000	Salary	216,667
Benefits cash ¹	147,272	Benefits cash	110,382
Benefits non-cash ²	118,554	Benefits non-cash	54,593
Annual cash bonus	585,000	Annual cash bonus	169,542
Value of deferred share bonus	585,000	Value of deferred share bonus	169,542
Cash dividend equivalent (DSBS) ³	19,919	Cash dividend equivalent (DSBS)	4,918
Cash dividend equivalent (LTIP) ³	111,468	Cash dividend equivalent (LTIP)	–
Share Reward Scheme value of shares received during the year	2,589	Share Reward Scheme value of shares received during the year	–
Total – see Table 4	2,219,802	Total – see Table 4	725,644

Notes

- Cash benefits comprise (1) a car allowance (£13,560); and (2) a contractual payment made in respect of the relocation of John Daly from Hong Kong (£133,712)
- Non-cash benefits comprise (1) life and health insurance (£6,191), (2) tax advice (£3,954), (3) the use of a company driver (£74,181), (4) the installation and maintenance of home security systems (£28,976), and (5) other expenses incurred in connection with individual and/or accompanied attendance at business functions and/or corporate events
- Cash dividend equivalent payments (1) DSBS – these are cash sums equivalent to the dividend on the after-tax position on all unvested ordinary shares comprised in the share awards held by participants in the DSBS at each dividend record date, and (2) LTIP – this is a cash sum equivalent to the dividends that an LTIP participant would have received as a shareholder on the actual number of shares under an LTIP award

Table 6 Directors' interests in British American Tobacco plc ordinary shares of 25p

	At 1 Jan 2011 or date of appointment	At 31 Dec 2011	Changes from 31 Dec 2011	At 21 Feb 2012
Richard Burrows	10,000	10,000	–	10,000
Nicandro Durante	112,167	150,261	1,430 ¹	151,691
Ben Stevens	77,902	58,059	–	58,059
John Daly	22,802	36,543	–	36,543
Karen de Segundo	2,000	2,000	–	2,000
Ann Godbehere (from 3 October 2011)	–	–	–	–
Robert Lerwill	3,000	3,000	–	3,000
Christine Morn-Postel	4,700	4,700	–	4,700
Gerry Murphy	3,000	3,000	–	3,000
Kieran Poynter	5,000	5,000	–	5,000
Anthony Ruys	3,000	3,000	–	3,000
Sir Nicholas Scheele	5,000	5,000	–	5,000
Total	248,571	280,563	1,430	281,993

Notes

- 1 The changes in Directors' interests since 31 December 2011 relate to (1) the purchase by Nicandro Durante of a total of 9 shares pursuant to the Company's Partnership Share Scheme, and (2) the acquisition of 1,421 shares following the exercise of a Sharesave option on 9 January 2012
- 2 Based on the performance for 2011, the Executive Directors will each be awarded a number of ordinary shares to the value of £3,000 pursuant to an appropriation of shares under the Share Reward Scheme on 2 April 2012
- 3 In addition to the shares shown above, the Executive Directors have further interests in the ordinary shares in the Company set out in Table 7 below and which are held in trust pursuant to the British American Tobacco DSBS. The value of these shares has been included as Directors' emoluments in the prior year. Details of the DSBS are given in the remuneration report
- 4 On 31 December 2011, the Group's employee share ownership trust referred to in the remuneration report held a total of 12,123,853 ordinary shares in the Company. All participating employees, including the Executive Directors, are deemed to have a beneficial interest in these shares

Appendices to the remuneration report continued

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

Nicandro Durante Shares – Long-Term Incentive Plan

Performance period	Award date	At 1 Jan 2011 Number of shares	Awarded in 2011 Number of shares	Vested in 2011 Number of shares	Lapsed in 2011 Number of shares	At 31 Dec 2011 Number of shares	Value vested in 2011 £	Vesting date	Illustrative value vesting 2012* £
2008/2010	15-May-08	74,962	–	74,962	–	–	2,015,353	15-May-11	–
2009/2011	27-Mar-09	94,996	–	–	–	94,996	–	27-Mar-12	2,958,175
2010/2012	25-Mar-10	69,751	–	–	–	69,751	–	25-Mar-13	–
2011/2013	13-May-11	–	147,329	–	–	147,329	–	13-May-14	–
Total		239,709	147,329	74,962	–	312,076	2,015,353		2,958,175

Deferred Share Bonus Scheme

Award date	At 1 Jan 2011 Number of shares	Awarded in 2011 Number of shares	Released in 2011 Number of shares	At 31 Dec 2011 Number of shares
13-Mar-08	6,028	–	6,028	–
27-Mar-09	29,164	–	–	29,164
25-Mar-10	17,005	–	–	17,005
25-Mar-11	–	22,056	–	22,056
Total	52,197	22,056	6,028	68,225

Options – Sharesave Scheme

At 1 Jan 2011 Number of shares	Grant date	Grant price	Granted in 2011 Number of shares	Exercised in 2011 ²³ Number of shares	At 31 Dec 2011 Number of shares	Dates from which exercisable	Latest expiry date
1,421	24-Nov-06	1,152 0p	–	–	1,421	Jan 2012	Jun 2012

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

Ben Stevens
Shares – Long-Term Incentive Plan

Performance period	Award date	At 1 Jan 2011 Number of shares	Awarded in 2011 Number of shares	Vested in 2011 Number of shares	Lapsed in 2011 Number of shares	At 31 Dec 2011 Number of shares	Value vested in 2011 £	Vesting date	Illustrative value vesting 2012 ² £
2008/2010	15-May-08	53,098	–	53,098	–	–	1,427,539	15-May-11	–
2009/2011	27-Mar-09	88,663	–	–	–	88,663	–	27-Mar-12	2,760,965
2010/2012	25-Mar-10	65,323	–	–	–	65,323	–	25-Mar-13	–
2011/2013	13-May-11	–	79,558	–	–	79,558	–	13-May-14	–
Total		207,084	79,558	53,098	–	233,544	1,427,539		2,760,965

Deferred Share Bonus Scheme

Award date	At 1 Jan 2011 Number of shares	Awarded in 2011 Number of shares	Released in 2011 Number of shares	At 31 Dec 2011 Number of shares
13-Mar-08	6,655	–	6,655	–
27-Mar-09	26,114	–	–	26,114
25-Mar-10	15,925	–	–	15,925
25-Mar-11	–	23,702	–	23,702
Total	48,694	23,702	6,655	65,741

Options – Sharesave Scheme

At 1 Jan 2011 Number of shares	Grant date	Grant price	Granted in 2011 Number of shares	Exercised in 2011 ^{2,3} Number of shares	At 31 Dec 2011 Number of shares	Dates from which exercisable	Latest expiry date
1,000	25-Nov-09	1,555 0p	–	–	1,000	Jan 2015	Jun 2015

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

Appendices to the remuneration report continued

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

John Daly

Shares – Long-Term Incentive Plan

Performance period	Award date	At 1 Jan 2011 Number of shares	Awarded in 2011 Number of shares	Vested in 2011 Number of shares	Lapsed in 2011 Number of shares	At 31 Dec 2011 Number of shares	Value vested in 2011 £	Vesting date	Illustrative value vesting 2012 ² £
2008/2010	15-May-08	37,481	–	37,481	–	–	1,007,676	15-May-11	–
2009/2011	27-Mar-09	51,931	–	–	–	51,931	–	27-Mar-12	1,617,131
2010/2012	25-Mar-10	37,643	–	–	–	37,643	–	25-Mar-13	–
2011/2013	13-May-11	–	71,823	–	–	71,823	–	13-May-14	–
Total		127,055	71,823	37,481	–	161,397	1,007,676		1,617,131

Deferred Share Bonus Scheme

Award date	At 1 Jan 2011 Number of shares	Awarded in 2011 Number of shares	Released in 2011 Number of shares	At 31 Dec 2011 Number of shares
13-Mar-08	5,872	–	5,872	–
27-Mar-09	15,151	–	–	15,151
25-Mar-10	8,601	–	–	8,601
25-Mar-11	–	17,833	–	17,833
Total	29,624	17,833	5,872	41,585

Options – Sharesave Scheme

At 1 Jan 2011 Number of shares	Grant date	Grant price	Granted in 2011 Number of shares	Exercised in 2011 ^{2,3} Number of shares	At 31 Dec 2011 Number of shares	Dates from which exercisable	Latest expiry date
–	25-Mar-11	1,974 0p	457	–	457	May 2014	Oct 2014

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

Former director**Paul Adams****Shares – Long-Term Incentive Plan**

Performance period	Award date	Vesting date	At 1 Jan 2011 Number of shares	Vested ⁶ in 2011 Percentage of award	Vested ⁶ in 2011 Number of shares	Lapsed in 2011 Number of shares	At 31 Dec 2011 Number of shares	Value vested in 2011 £
2008/2010	15-May-08	15-May-11	163,418	100	163,418	–	–	4,037,241
2009/2011	27-Mar-09	27-Mar-12	224,192	86.5	140,057	84,135	–	3,460,108
2010/2012	25-Mar-10	25-Mar-13	162,754	81.4	51,520	111,234	–	1,272,801
Total			550,364		354,995	195,369	–	8,770,150

Deferred Share Bonus Scheme

Award date	At 1 Jan 2011 Number of shares	Awarded in 2011 Number of shares	Released ¹ in 2011 Number of shares	At 31 Dec 2011 Number of shares
13-Mar-08	25,603	–	25,603	–
27-Mar-09	63,297	–	63,297	–
25-Mar-10	36,728	–	36,728	–
Total	125,628	–	125,628	–

Long-Term Incentive Plan Notes

- The closing mid-market price of ordinary shares in British American Tobacco p.l.c. on the following award dates was: 15 May 2008 (1,966 Op), 27 March 2009 (1,534 Op), 25 March 2010 (2,278 Op), and 13 May 2011 (2,704 Op)
- The March 2009 award will vest on 27 March 2012 at 100 per cent in the manner described in the remuneration report. For illustrative purposes only, the share price on 21 February 2012, being the latest practicable date prior to publication, of 3,114 Op has been used to value the vesting awards.
- The performance conditions applicable to the LTIP awards relate to an apportionment between measures relating to TSR and EPS-based criteria with reference to a three year performance period. TSR combines both the share price and dividend performance of the Company as set against two comparator groups: (a) the FTSE 100 Index at the beginning of the performance period, and (b) a peer group of FMCG companies. A total of 50 per cent of the total award is based upon each of two separate measures (25 per cent for each measure). 50 per cent of an award is based on EPS growth relative to inflation. Further details of the performance conditions are set out in the long-term incentives section of the remuneration report.
- There have been no variations in the terms and conditions of the LTIP interests during the year.
- The awards made in March 2010 and May 2011 are due to vest in March 2013 and May 2014 respectively. At 31 December 2011, the performance percentage reflecting performance to date, was 91.4 per cent for the March 2010 award and 77.4 per cent for the March 2011 award.
- Paul Adams retired as a Director on 28 February 2011. The Remuneration Committee agreed that, in accordance with the LTIP rules, his outstanding LTIP awards of shares would vest immediately upon his retirement (the Awards). The 2008 Award, having completed the entire performance period, vested in full. The 2009 Award and the 2010 Award vested on a pro-rated time and performance basis.

Appendices to the remuneration report continued

Deferred Share Bonus Scheme Notes

- 1 Each Executive Director has an interest in the ordinary shares of the Company, as shown in the Deferred Share Bonus Scheme tables, which are held in trust pursuant to the British American Tobacco Deferred Share Bonus Scheme
- 2 The cost of these shares has been included as Directors' emoluments in the prior year. Details of the Deferred Share Bonus Scheme are given in the remuneration report
- 3 The DSBS shares awarded on 13 March 2008 were released on 14 March 2011. The closing mid-market price of ordinary shares in British American Tobacco p.l.c. on 14 March 2011 was 2,366 0p
- 4 Paul Adams retired as a Director on 28 February 2011. The Remuneration Committee agreed that the unvested awards of 125,628 ordinary shares made to Paul Adams would vest in full immediately upon his retirement in accordance with the rules of the Deferred Share Bonus Scheme. Subject to a sale of 26,923 shares to cover tax liabilities, 98,705 shares were transferred to Paul Adams on 1 March 2011

Sharesave Scheme Notes

- 1 On 9 January 2012 Nicandro Durante acquired 1,421 ordinary shares following the exercise of options held under the Sharesave Scheme at an option price of 1,152 0p per share
- 2 Sharesave Scheme in respect of the Executive Directors, no options lapsed during the year ended 31 December 2011. There have been no variations in the terms and conditions of these interests in share options during the year. Options granted under the Sharesave Scheme are exercisable in conjunction with a three year or five year savings contract up to a monthly limit of £250. Options are normally granted at a discount of 20 per cent to the market price at the time of the invitation, as permitted under the rules of the Sharesave Scheme
- 3 The aggregate gain on the exercise of Sharesave Scheme options in 2011 was £nil (2010 £81,912)
- 4 The closing mid-market price of ordinary shares in British American Tobacco p.l.c. on 30 December 2011 (being the last trading day of the year) was 3,055 5p and the range during the year was 2,282 5p to 3,068 0p. The market price on 31 December 2011 exceeded the grant price of all the options detailed in the Options tables for the Executive Directors

Table 8 Executive Directors' pension entitlements – audited

	Normal retirement age	Total accrued pension at 31 Dec 2011 £	Gross increase in accrued pension £	Increase in accrued pension net of inflation £	Transfer value of net increase in accrual over period £	Transfer value of accrued pension at 31 Dec 2010 £	Transfer value of accrued pension at 31 Dec 2011 £	Total change in transfer value during period £
Nicandro Durante ⁵	60	465,256	339	(22,052)	(555,831)	9,840,627	11,727,138	1,886,511
Ben Stevens ³	60	231,047	41,552	32,426	776,422	3,737,054	5,532,318	1,795,264
John Daly ^{3,4}	60	208,942	37,809	29,567	754,877	3,680,288	5,334,521	1,654,233
Former Director								
Paul Adams ⁶	60	603,382	(23,157)	(53,332)	(1,391,721)	14,767,041	16,792,555	2,025,514

Notes

- The amount of total accrued pension is the pension that would be paid annually on retirement based on service to the end of the year, excluding any increase granted under statute before retirement.
- The value of net increase in accrued pension represents the incremental value to the Executive Director of his service during the year, calculated on the assumption that service terminated at the year end.
- The pension accrual in the Pension Fund for John Daly and Ben Stevens has, with member consent, been restricted to the statutory annual allowance of £50,000 per annum with the balance of approximately £1,840 per annum being provided through the UURBS. There has been no change to the overall pension entitlement of either Director.
- John Daly was formerly a member of the P J Carroll Directors' Plan in Ireland. He is entitled to a deferred benefit currently amounting to €107,479 per annum, payable from the age of 60. This deferred benefit is scheduled to increase each year between January 2011 and December 2015 by the lower of 4 per cent or the Irish Consumer Prices Index. The increased amount is confirmed each year by the Minister of Social Protection (the increase for 2011 is 1.75 per cent). The transfer value in respect of John Daly's deferred benefit is included in Table 8 above and has been calculated in accordance with the method used for the Pension Fund.
- Nicandro Durante is entitled to a benefit promise of 0.65 per cent of final sterling pensionable salary (calculated as a 12 month average) in relation to service from 1 March 2006. This is provided through the UURBS. At the point where the sterling pensionable salary exceeds £670,000 as an initial base, then the accrual rate will increase from 0.65 per cent as stated above to 2.50 per cent in respect of base salary in excess of £670,000 for each year of service and will continue to be provided through the UURBS. In addition, Nicandro Durante is entitled to a pension from the Souza Cruz Pension Scheme based on an accrual rate of 1.85 per cent of final Brazilian real pensionable salary (calculated as a 12 month average) in relation to service from December 1981 (the value of this pension – in terms of sterling – has decreased during 2011 due to a 13 per cent fall in value of the Brazilian real). The accrued pension amount and transfer value shown above are based on the sum of these promises, with the accrual rate since March 2006 being a total of 2.50 per cent. Nicandro Durante is entitled to receive that part of the promise from the Souza Cruz Pension Scheme (based on 1.85 per cent accrual rate) with immediate effect, this right to take the benefit early has been ignored for the purposes of the calculation of the above transfer value.
- Paul Adams retired as a Director on 28 February 2011. He elected to commute part of his pension for a cash lump sum of £450,000 at his retirement and he received £90,092 in respect of benefits that exceeded the statutory lifetime allowance, as permitted under the rules of the Pension Fund. The figures shown in Table 8 above exclude the amount which relates to that cash lump sum.
- Changes in the transfer values reflect both individual Executive Director's circumstances such as the date of joining the Pension Fund and changes in salary during the year, together with the application of market value adjustments in accordance with actuarial and legislative requirements. The increase in the transfer values during the year ended 31 December 2011 was largely attributable to the underlying reduction in gilt yields from 4.22 per cent to 3.13 per cent.

The transfer value basis used is consistent with that used by the Trustee of the Pension Fund for the ongoing funding of the Pension Fund. The transfer values of the accrued entitlement represent the value of assets that the Pension Fund would need to transfer to another pension provider on transferring the Pension Fund's liability in respect of Executive Director's pension benefits. They do not represent sums payable to individual Executive Directors and, therefore, cannot be added meaningfully to annual remuneration.

Further, although Nicandro Durante is not a member of the Pension Fund, the transfer values calculated above have been calculated in accordance with the method used for the Pension Fund. Although Paul Adams, John Daly and Ben Stevens receive a significant element of their overall entitlement from the UURBS, the transfer values above have been calculated in accordance with the method used for the Pension Fund.
- The Pension Fund is non-contributory. Voluntary contributions paid by Executive Directors and resulting benefits are not shown. No excess retirement benefits have been paid to or are receivable by any Executive Director or past Executive Director.

Appendices to the remuneration report continued

Table 9 Non-Executive Director's share options
Ordinary Shares of INR1 each in ITC Limited – audited

Anthony Ruys
ITC Employee Stock Option Schemes

At 1 Jan 2011 Number of options ²	At 1 Jan 2011 Number of shares over which options held ²	Grant date	Grant price per option	Granted in 2011 Number of options	Number of shares over which options granted	Exercised in 2011 Number of options	At 31 Dec 2011 Number of options	Number of options that may be exercised	Dates from which exercisable	Latest expiry date
20,000	200,000	23-Jul-09	Rs 1,090.00	-	-	-	20,000	6,000	23-Jul-10	23-Jul-15
								6,000	23-Jul-11	23-Jul-16
								8,000	23-Jul-12	23-Jul-17
20,000	200,000	22-Jul-10	Rs 1,461.75	-	-	-	20,000	6,000	22-Jul-11	22-Jul-16
								6,000	22-Jul-12	22-Jul-17
								8,000	22-Jul-13	22-Jul-18
-	-	26-Aug-11	Rs 2,023.5	20,000	200,000	-	20,000	6,000	26-Aug-12	26-Aug-17
								6,000	26-Aug-13	26-Aug-18
								8,000	26-Aug-14	26-Aug-19
Total	40,000	400,000		20,000	200,000	-	60,000	60,000		

Notes

- 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 Schemes 2006 and 2010 which provide 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 Schemes).
- Each option entitles its holder to apply for and to be allotted 10 ordinary shares in ITC of INR1 each upon the payment of the grant price during the appropriate exercise period. An exercise period begins at the date of vesting of an option and expires at the end of five years from that vesting date. The vesting periods for the conversion of an option under the Schemes are as follows: (a) 30 per cent vests 12 months from date of grant, (b) 30 per cent vests 24 months from date of grant, and (c) 40 per cent vests 36 months from the date of grant.

Status of remuneration report

This report has been prepared in accordance with the relevant provisions of the Companies Act 2006 and Schedule 5 and Schedule 8 to the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008. The report also meets the relevant requirements of the Listing Rules of the UK Listing Authority and describes how the Board has applied the Principles of Good Governance relating to Directors' remuneration as set out in the UK Corporate Governance Code referred to in the corporate governance statement. As required by the Companies Act 2006, a resolution to approve the Directors' remuneration report (the Report) will be proposed at the Annual General Meeting of the Company on 26 April 2012, at which the financial statements will be presented for approval. The vote will have advisory status, will be in respect of the remuneration policy and overall remuneration packages and will not be specific to individual levels of remuneration. The Companies Act 2006 requires the auditors to report to the Company's shareholders on the 'audited information' within the Report and to state whether, in their opinion, those parts of the Report have been prepared in accordance with the Companies Act 2006. The report of the independent auditors, in respect of the Company, addresses those aspects of this Report, and those which have been subject to audit have been clearly marked Table 1, Table 2, Table 3, Table 4, Table 5, Table 7, Table 8 and Table 9.

On behalf of the Board

Anthony Ruys
 Chairman of the Remuneration Committee
 22 February 2012

Other statutory and regulatory information

Nicola Snook
Secretary

Companies Act 2006

The Companies Act 2006 requires the Company to set out in this report the development and performance of the business of the Group during the financial year ended 31 December 2011, including an analysis of the position of the Group at the end of the financial year, and a description of the principal risks and uncertainties facing the Group

Principal activities

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

Group results and dividends

The Group results are addressed fully in the financial statements and in the Directors' report: business review. The Board recommends to shareholders a final dividend of 88.4p per ordinary share of 25p for the year ended 31 December 2011. If approved by shareholders at the Annual General Meeting to be held on 26 April 2012, the dividend will be payable on 3 May 2012 to shareholders registered on either the UK main register or the South African branch register on 9 March 2012, the record date. The ex-dividend trading dates are 5 March 2012 on the JSE Limited (JSE) and 7 March 2012 on the London Stock Exchange (LSE). As the Group reports in sterling, dividends are declared and payable in sterling except for shareholders on the branch register in South Africa whose dividends are payable in rand.

A rate of exchange of £ R = 12.19960 as at 21 February 2012 (the closing rate for that date as quoted on Bloomberg), results in an equivalent final dividend of 1,078.44464 SA cents per ordinary share.

From the commencement of trading on 23 February 2012 (the date of the preliminary announcement) to 9 March 2012 (inclusive), no removal requests between the UK main register and the South African branch register (in either direction) are permitted. Further, from the close of business on 2 March 2012 until the close of business on 9 March 2012 (inclusive), no transfers between the UK main register and the South African branch register are permitted and no shares may be dematerialised or rematerialised between 5 March 2012 and 9 March 2012, both days inclusive.

Further details of the total amounts of dividends paid in 2011 (with 2010 comparatives) are given in note 8 on the accounts.

Share capital

As at 31 December 2011, the Company had an allotted and fully paid share capital of 2,025,986,670 ordinary shares of 25p each with an aggregate nominal value of £506 million (including treasury shares and shares owned by the employee share trusts).

Purchase of own shares

The Board reinstated its on-market share buy-back programme following the Company's Preliminary Announcement on 24 February 2011 and under the authority granted by shareholders in 2010. At the 2011 Annual General Meeting, the Company was given authority to purchase up to 199,400,000 of its ordinary shares. The minimum price that may be paid for such shares is 25p and the maximum price is an amount equal to 105 per cent of the average of the middle market prices shown in the quotation for an ordinary share as derived from the London Stock Exchange Daily Official List for the five business days immediately preceding the day on which the ordinary share is contracted to be purchased.

During the year ended 31 December 2011, the Company made on-market repurchases totalling 28,037,708 of its own ordinary shares, representing 1.4 per cent of the issued share capital (excluding treasury shares) as at 31 December 2011 and at a value of £750 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 2011 the number of treasury shares was 56,997,762. 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.

The present authority for the Company to purchase its own shares will expire at the 2012 Annual General Meeting where it is proposed that the Company's authority to purchase its own shares is renewed. This will enable the share buy-back programme to continue for a further year. In the opinion of the Directors, the exercise of this authority is likely to result in an increase in the Company's earnings per share and will be in the interests of its shareholders generally. Details of the applicable resolution and explanatory notes are contained in the Notice of Annual General Meeting which is sent to all shareholders and is also published on www.bat.com.

Significant agreements – change of control

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

Other statutory and regulatory information continued

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

On 10 July 2009, British American Tobacco Tutun Mamullen Sanayi ve Ticaret Anonim Sirketi (as borrower), the Company and B.A.T. International Finance p.l.c. (as guarantors) entered into a term credit facility agreement with Barclays Bank PLC (as agent) and certain financial institutions (as lenders) pursuant to which the lenders agreed to make available to the borrower €700 million to refinance existing facilities and for general corporate purposes (the Facility). In December 2010, the borrower prepaid €250 million of the outstanding amount. Pursuant to the Facility, should the borrower cease to be a direct or indirect subsidiary of the Company, the borrower shall immediately repay any outstanding advances. Where there is a change of control in respect of the Company, the lenders can require all amounts outstanding under the Facility to be repaid.

On 25 November 2010, the Company, B.A.T. International Finance p.l.c. and British American Tobacco Holdings (The Netherlands) B.V. (as borrowers and, in the case of the Company, as a borrower and guarantor) entered into a revolving credit facility agreement with HSBC Bank plc (as agent) and certain financial institutions (as lenders) pursuant to which the lenders agreed to make available to the borrowers £2 billion for general corporate purposes (the Facility). Pursuant to the Facility, should a borrower (other than the Company) cease to be a direct or indirect subsidiary of the Company, such borrower shall immediately repay any outstanding advances made to it. Where there is a change of control in respect of the Company, the lenders can require all amounts outstanding under the Facility to be repaid.

Details of the change of control provisions contained in the Company's Long-Term Incentive Plans are given in the remuneration report.

Contractual arrangements

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

Articles of Association

The following description summarises certain provisions of the Company's current Articles of Association (as adopted by special resolution at the Annual General Meeting on 28 April 2010), applicable English law and the Companies Act 2006 (the Companies Act). This summary is qualified in its entirety by reference to the Companies Act and the Company's Articles of Association, a copy of which is available on www.bat.com.

Share capital

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

Objects and purposes

The Company is incorporated under the name of British American Tobacco p.l.c. and is registered in England and Wales under registered number 3407696. Under the Companies Act 2006, the Company's objects are unrestricted.

Directors' appointment and retirement

The Company's Articles of Association provide for a Board of Directors, consisting (unless otherwise determined by ordinary resolution of the shareholders) of not fewer than five Directors, not subject to any maximum, who shall manage the business of the Company.

The Directors and the Company (by ordinary resolution) may appoint a person who is willing to act as a Director, either to fill a vacancy or as an additional Director. A Director appointed by the Directors shall retire at the next Annual General Meeting and will put himself/herself forward to be reappointed by the shareholders. Such a Director shall not be taken into account in determining the number or identity of the Directors to retire by rotation at that next Annual General Meeting.

At each Annual General Meeting, all Directors shall retire from office by rotation who (1) held office at the time of each of the two preceding Annual General Meetings and who did not retire at either of them, and (2) if the number of Directors retiring in (1) above is less than one-third of the Directors who are subject to retirement by rotation (or, if their number is not three or a multiple of three, is less than the number which is nearest to but does not exceed one-third of the Directors), such additional number of Directors as shall, together with the Directors retiring under (1) above, equal one-third of the Directors (or, if their number is not three or a multiple of three, the number which is nearest to but does not exceed one-third of the Directors).

Subject to the provisions of the Companies Act and the Articles of Association, the Directors to retire at an Annual General Meeting under (2) above will be those who have been in office the longest since their appointment or last reappointment.

Notwithstanding these provisions contained in the Articles of Association, the Company is not restricted to the number of Directors who may retire and seek re-election each year. The Articles of Association merely set a minimum number of Directors who must be subject to retirement by rotation each year. As a

result, since the introduction of the provision of UK Corporate Governance Code in 2011 that all Directors of FTSE 350 companies should be subject to annual re-election by shareholders, all of the Directors of the Company will be subject to either election (i.e. those Directors appointed by the Board of Directors during the year) or re-election at the forthcoming Annual General Meeting to be held on 26 April 2012

A Director who retires at an Annual General Meeting and is not reappointed shall remain office until the meeting elects someone in his place or, if it does not do so, until the conclusion of the meeting

In addition to any power of removal under the Companies Act, the Company may, by special resolution, remove a Director before the expiration of his period of office and, subject to the Articles of Association, may by ordinary resolution, appoint another person who is willing to act as a Director, and is permitted by law to do so, to be a Director instead of him. A person so appointed shall be subject to retirement as if he had become a Director on the day on which the Director in whose place he is appointed was last appointed or reappointed a Director

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

Directors meetings and voting

The quorum for meetings of Directors is two Directors. The Directors may delegate any of their powers which 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 one per cent or more of the equity share capital of that company (or of any other company through which his interest is derived) and not entitled to exercise one per cent or more of the voting rights available to members of the relevant company (disregarding, for the purposes of this proviso (i) any shares held by a Director as bare or custodian trustee and in which he has no beneficial interest, (ii) any shares comprised in an authorised unit trust scheme in which the Director is interested only as a unit holder; and (iii) any shares of that class held as treasury shares)

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

Directors borrowing powers

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

Directors interests

Provided that the Director has disclosed to the other Directors the nature and extent of any material interest of his, a Director, notwithstanding his office

- 1 may be a party to, or otherwise interested in, any transaction or arrangement with the Company or in which the Company is otherwise interested,
- 2 may be a Director or other officer of, or employed by or may be a party to, or otherwise interested in, any transaction or arrangement with anybody corporate promoted by the Company or in which the Company is otherwise interested,
- 3 shall not, by reason of his office, be accountable to the Company for any benefit which he derives from any such office or employment or from any such transaction or arrangement or from any interest in any such body corporate,

Other statutory and regulatory information continued

- 4 shall not infringe his duty to avoid a situation in which he has, or can have, a direct or indirect interest that conflicts, or may possibly conflict, with the interests of the Company as a result of any such office or employment or from any such transaction or arrangement or from any interest in any such body corporate,
- 5 shall not be required to disclose to the Company, or use in performing his duties as a Director of the Company, any confidential information relating to such office or employment if to make such a disclosure or use would result in a breach of duty or obligation of confidence owed by him in relation to or in connection with that office or employment,
- 6 may absent himself from discussions and exclude himself from information, which will or may relate to that office, employment, transaction, arrangement or interest, and
- 7 no such transaction or arrangement will be liable to be avoided because of any such interest or benefit

For the purposes of the Articles, a general notice given to the Directors that he is to be regarded as having an interest of the nature and extent specified in the notice in any transaction or arrangement in which a specified person or class of persons is interested is deemed to be a disclosure that the Director has an interest in any such transaction of the nature and extent so specified

An interest of which a Director has no knowledge and of which it is unreasonable to expect him to have knowledge is not treated as an interest, an interest which consists of a Director being a Director or other officer of, or employed by any subsidiary of the Company is not deemed to be a material interest, a Director need not disclose an interest if it cannot be reasonably regarded as likely to give rise to a conflict of interest, and a Director need not disclose an interest if, or to the extent that, the other Directors are already aware of it

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

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

- 1 any matter which would otherwise result in a Director infringing his duty to avoid a situation in which he has, or can have, a direct or indirect interest that conflicts, or possibly may conflict, with the interests of the Company and which may reasonably be regarded as likely to give rise to a conflict of interest (including a conflict of interest and duty or conflict of duties),
- 2 a Director to accept or continue in any office, employment or position in addition to his office as a Director of the Company and may authorise the manner in which a conflict of interest arising out of such office, employment or position may be dealt with, either before or at the time that such a conflict of interest arises, provided that the authorisation is only effective if
 - 1 any requirement as to the quorum at the meeting at which the matter is considered is met without counting the Director in question or any other interested Director; and
 - 2 the matter was agreed to without their voting or would have been agreed to if their votes had not been counted

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

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

Dividend rights

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

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

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

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

The Directors may elect to make payments of dividends to shareholders by bank or electronic transfer only. Amounts due to shareholders who provide no, or invalid, account details may be held in an account in the Company's name until such shareholders nominate a valid account. The Company shall not be a trustee of any such monies, shall be deemed to have discharged its payment obligations by paying the relevant monies into such account and interest will not accrue for shareholders on any such monies pending payment to such persons.

Voting rights

Voting at any general meeting of shareholders is by a show of hands unless a poll is demanded. On a show of hands, every shareholder who is present in person at a general meeting has one vote regardless of the number of shares held by the shareholder.

Every proxy appointed by a shareholder and present at a general meeting has one vote, except that if the proxy has been duly appointed by more than one shareholder entitled to vote on the resolution and is instructed by one or more of those shareholders to vote for the resolution and by one or more others to vote against it, or is instructed by one or more of those shareholders to vote in one way and is given discretion as to how to vote by one or more others (and wishes to use that discretion to vote in the other way) he has one vote for and one vote against the resolution.

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

- 1 the Chairman of the meeting,
- 2 the Directors,
- 3 not less than five shareholders having the right to vote at the meeting,
- 4 a shareholder or shareholders representing not less than one-tenth of the total voting rights of all shareholders having the right to vote at the meeting (excluding any voting rights attached to treasury shares), or
- 5 a shareholder or shareholders holding shares which confer a right to vote on the resolution at the meeting being shares on which an aggregate sum has been paid up equal to not less than one-tenth of the total sum paid up on all shares conferring that right (excluding any voting rights attached to treasury shares).

Matters are transacted at general meetings of the Company by 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;

Other statutory and regulatory information continued

- 2 is in respect of only one class of share, and
- 3 is in favour of not more than four transferees

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

If the Directors refuse to register a transfer of shares, they must give the transferee notice of this refusal as soon as practicable and in any event within two months of the instrument of transfer being lodged with the Company. No fees may be charged for the registration of a transfer of shares.

Pre-emptive rights and new issues of shares

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

Alteration of share capital

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

- 1 consolidate and divide all or any of its shares into shares of a larger amount than its existing shares,
- 2 sub-divide any of its shares into shares of smaller amount than its existing shares, and
- 3 determine that, as between the shares resulting from such a sub-division, any of them may have any preference or advantage as compared with the others.

Subject to the provisions of the Companies Act

- 1 the Company may reduce its share capital, its capital redemption reserve and any share premium account in any way, and
- 2 the Company may purchase its own shares, including redeemable shares, and may hold such shares as treasury shares or cancel them.

Disclosure of interests in the Company's shares

There are no provisions in the Articles of Association whereby persons acquiring, holding or disposing of a certain percentage of the Company's shares are required to make disclosure of their ownership percentage, although there are such requirements under statute and regulation. The basic disclosure requirement

under Part 6 of the Financial Services and Markets Act 2000 and Rule 5 of the Disclosure Rules and the Transparency Rules made by the Financial Services Authority imposes a statutory obligation on a person to notify the Company and the Financial Services Authority of the percentage of the voting rights in the Company he directly or indirectly holds or controls, or has rights over, through his direct or indirect holding of certain financial instruments, if the percentage of those voting rights

- 1 reaches, exceeds or falls below 3 per cent 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 Annual General Meeting 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 Annual General Meetings 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 Annual General Meeting every year approving that shortening of the notice period to 14 days. A special resolution enabling the Company to hold general meetings (other than Annual General Meetings) on 14 days' notice will be proposed at the Annual General Meeting to be held on 26 April 2012.

Subject to the resolution being passed, the approval of the shortening of the notice period will be effective until the Company's next AGM, when it is intended that the approval be renewed. The shorter notice period would not be used as a matter of routine. Rather the Directors will consider on a case-by-case basis whether the use of the flexibility offered by the shorter notice period is merited, taking into account the circumstances, including whether the business of the meeting is

time sensitive, and is thought to be to the advantage of shareholders as a whole. Further, the shorter notice period would not be used unless both of the conditions as stated above are met.

Variation of rights

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

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

Repurchase of shares

Subject to authorisation by shareholder resolution, the Company may purchase its own shares in accordance with the Companies Act. Any shares which have been bought back may be held as treasury shares or, if not so held, must be cancelled immediately upon completion of the purchase, thereby reducing the amount of the Company's issued share capital. There is no longer a requirement for public companies to have specific authorisations in their articles of association to undertake these actions.

Creditor payment policy

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

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

Creditor days have not been calculated for the Company as it is an investment holding Company and had no trade creditors at 31 December 2011.

Intra-Group pricing

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

On behalf of the Board

Nicola Snook
Secretary
22 February 2012
British American Tobacco plc



Registered in England and Wales No. 3407696

Responsibility of Directors

Directors' responsibilities in relation to the financial statements

The following statement sets out the responsibilities of the Directors in relation to the financial statements of both the Group and the Company. The reports of the independent auditors for the Group and the Company set out their responsibilities in relation to those financial statements.

Company law requires the Directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the Company and the Group as at the end of the financial year and of the profit or loss of the Group and the Company for the financial year. In preparing those financial statements, the Directors are required to

- select appropriate accounting policies and apply them consistently,
- make judgments and estimates that are reasonable and prudent,
- state whether applicable accounting standards have been followed, subject to any material departures being disclosed and explained, and
- prepare the financial statements on the going concern basis, unless they consider that to be inappropriate.

The applicable accounting standards referred to above are (a) United Kingdom Generally Accepted Accounting Principles (UK GAAP) for the Company, and (b) International Financial Reporting Standards (IFRS) as adopted by the European Union and implemented in the UK for the Group.

The Directors are responsible for ensuring that the Company keeps sufficient accounting records to disclose with reasonable accuracy the financial position of the Company and the Group and to enable them to ensure that the Group financial statements comply with the Companies Act 2006 and Article 4 of the IAS Regulation, and that the Company financial statements and the Directors' remuneration report comply with the Companies Act 2006. They are also responsible for taking reasonable steps to safeguard the assets of the Company and the Group and, in that context, having proper regard to the establishment of appropriate systems of internal control with a view to the prevention and detection of fraud and other irregularities.

The Directors are required to prepare financial statements and to provide the auditors with every opportunity to take whatever steps and undertake whatever inspections the auditors consider to be appropriate for the purpose of enabling them to give their audit report.

The Directors are responsible for the maintenance and integrity of the Annual Report on www.bat.com in accordance with the UK legislation governing the preparation and dissemination of financial statements. Access to the website is available from outside the UK, where comparable legislation may be different.

The Directors consider that they have pursued the actions necessary to meet their responsibilities as set out in this statement.

Directors' declaration in relation to relevant audit information

Having made enquiries of fellow Directors and of the Company's auditors, each of the Directors confirms that

- to the best of his or her knowledge and belief, there is no relevant audit information of which the Company's auditors are unaware, and
- he or she has taken all steps that a Director might reasonably be expected to have taken in order to make himself or herself aware of relevant audit information and to establish that the Company's auditors are aware of that information.

Directors' responsibility statement

The Directors confirm to the best of their knowledge and belief that

- the financial statements, prepared in accordance with the applicable accounting standards identified above, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company and the Group, and
- the Directors' report (which incorporates the business review) includes a fair review of the development and performance of the business and the position of the Group and the Company, together with a description of the principal risks and uncertainties that they face.

The names of the Directors are listed in this Directors' report and their details appear on the Board of Directors page.

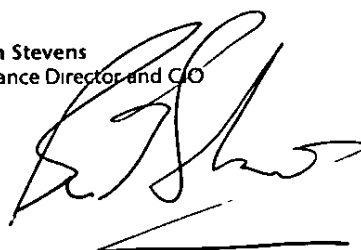
Neither the Company nor the Directors accept any liability to any person in relation to this Annual Report except to the extent that such liability could arise under English law. Accordingly, any liability to a person who has demonstrated reliance on any untrue or misleading statement or omission shall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

The responsibility statement was approved by the Board of Directors on 22 February 2012 and signed on its behalf by

Richard Burrows
Chairman



Ben Stevens
Finance Director and CFO



Independent auditors' report

To the members of British American Tobacco p.l.c.

We have audited the Group financial statements of British American Tobacco p.l.c. for the year ended 31 December 2011 which comprise the Group income statement, the Group statement of comprehensive income, the Group statement of changes in equity, the Group balance sheet, the Group cash flow statement, the notes on the accounts and the Principal subsidiary undertakings and the Principal associate undertakings. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRS) as adopted by the European Union.

Respective responsibilities of Directors and auditors

As explained more fully in the Directors' responsibility statement set out on page 108, the Directors are responsible for the preparation of the Group financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the Group financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report, including the opinions, has been prepared for and only for the Company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of whether the accounting policies are appropriate to the Group's circumstances and have been consistently applied and adequately disclosed, the reasonableness of significant accounting estimates made by the Directors, and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies, we consider the implications for our report.

Opinion on financial statements

In our opinion the Group financial statements

- give a true and fair view of the state of the Group's affairs as at 31 December 2011 and of its profit and cash flows for the year then ended,
- have been properly prepared in accordance with IFRS as adopted by the European Union, and
- have been prepared in accordance with the requirements of the Companies Act 2006 and Article 4 of the IAS Regulation.

Opinion on other matter prescribed by the Companies Act 2006

In our opinion the information given in the Directors' report for the financial year for which the Group financial statements are prepared is consistent with the Group financial statements.

Matters on which we are required to report by exception

We have nothing to report in respect of the following

Under the Companies Act 2006 we are required to report to you if, in our opinion

- certain disclosures of Directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Under the Listing Rules we are required to review

- the Directors' statement, set out on page 108, in relation to going concern,
- the part of the Corporate governance statement relating to the Company's compliance with the nine provisions of the UK Corporate Governance Code specified for our review, and
- certain elements of the report to shareholders by the Board on Directors' remuneration.

Other matter

We have reported separately on the Parent Company financial statements of British American Tobacco p.l.c. for the year ended 31 December 2011 and on the information in the remuneration report that is described as having been audited.



Paul Cragg (Senior Statutory Auditor)
for and on behalf of PwCwaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London, United Kingdom

22 February 2012

Group Income Statement

For the year ended 31 December

	Notes	2011 £m	2010 £m
Gross turnover (including duty, excise and other taxes of £30,724 million (2010: £28,972 million))		46,123	43,855
Revenue	2	15,399	14,883
Raw materials and consumables used		(3,507)	(3,695)
Changes in inventories of finished goods and work in progress		81	(12)
Employee benefit costs	3(a)	(2,501)	(2,550)
Depreciation, amortisation and impairment costs	3(b)	(817)	(897)
Other operating income	3(c)	233	207
Other operating expenses	3(d)	(4,167)	(3,618)
Profit from operations	2	4,721	4,318
Analysed as			
– adjusted profit from operations	2	5,519	4,984
– restructuring and integration costs	3(e)	(193)	(311)
– amortisation of trademarks	3(f)	(58)	(62)
– impairment of trademarks	3(g)		(44)
– goodwill impairment	3(g)	(273)	(249)
– Fox River	3(h)	(274)	
		4,721	4,318
Finance income		117	27
Finance costs		(577)	(507)
Net finance costs	4	(460)	(480)
Share of post-tax results of associates and joint ventures	5	670	550
Analysed as			
– adjusted share of post-tax results of associates and joint ventures	2	659	622
– issue of shares and change in shareholding	5	28	(9)
– smoking cessation programme	5	(23)	
– gain on disposal of business	5	22	
– Canadian settlements	5		(59)
– other	5	(16)	(4)
		670	550
Profit before taxation		4,931	4,388
Taxation on ordinary activities	6	(1,556)	(1,248)
Profit for the year		3,375	3,140
Attributable to			
Owners of the parent		3,095	2,879
Non-controlling interests		280	261
		3,375	3,140
Earnings per share			
Basic	7	157 p	145 p
Diluted	7	156 p	144 p

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

The accompanying notes are an integral part of the Group financial statements

Group Statement of Comprehensive Income

For the year ended 31 December

	Notes	2011 £m	2010 £m
Profit for the year (page 110)		3,375	3,140
Other comprehensive income			
Differences on exchange			
– subsidiaries		(411)	502
– associates		(109)	105
Differences on exchange reclassified and reported in profit for the year		(4)	(3)
Cash flow hedges			
– net fair value losses		(21)	(106)
– reclassified and reported in profit for the year		38	55
– reclassified and reported in net assets		(5)	3
Available-for-sale investments			
– net fair value gains		26	4
– reclassified and reported in profit for the year		(1)	
Net investment hedges			
– net fair value gains/(losses)		62	(31)
– differences on exchange on borrowings		(104)	74
Retirement benefit schemes			
– net actuarial (losses)/gains in respect of subsidiaries	12	(462)	193
– surplus recognition and minimum funding obligations in respect of subsidiaries	12	2	58
– actuarial losses in respect of associates net of tax	11	(67)	(54)
Tax on items recognised directly in other comprehensive income	6(d)	20	1
Total other comprehensive income for the year, net of tax		(1,036)	801
Total comprehensive income for the year, net of tax		2,339	3,941
Attributable to			
Owners of the parent		2,094	3,664
Non-controlling interests		245	277
		2,339	3,941

The accompanying notes are an integral part of the Group financial statements

Group Statement of Changes in Equity

At 31 December

	Notes	Attributable to owners of the parent					Non-controlling interests £m	Total equity £m
		Share capital £m	Share premium, capital redemption and merger reserves £m	Other reserves £m	Retained earnings £m	Total attributable to owners of parent £m		
Balance at 1 January 2011		506	3,910	1,600	3,190	9,206	342	9,548
Total comprehensive income for the year (page 111)				(488)	2,582	2,094	245	2,339
Profit for the year					3,095	3,095	280	3,375
Other comprehensive income for the year				(488)	(513)	(1,001)	(35)	(1,036)
Employee share options					76	76		76
– value of employee services					2	5		5
– proceeds from shares issued			3					
Dividends and other appropriations					(2,358)	(2,358)		(2,358)
– ordinary shares							(279)	(279)
– to non-controlling interests								
Purchase of own shares					(123)	(123)		(123)
– held in employee share ownership trusts					(755)	(755)		(755)
– share buy-back programme					(10)	(10)		(10)
Non-controlling interests – acquisitions	29				32	32	(1)	31
Other movements								
Balance at 31 December 2011		506	3,913	1,112	2,636	8,167	307	8,474

	Notes	Attributable to owners of the parent					Non-controlling interests £m	Total equity £m
		Share capital £m	Share premium, capital redemption and merger reserves £m	Other reserves £m	Retained earnings £m	Total attributable to owners of parent £m		
Balance at 1 January 2010		506	3,907	1,032	2,168	7,613	299	7,912
Total comprehensive income for the year (page 111)				568	3,096	3,664	277	3,941
Profit for the year					2,879	2,879	261	3,140
Other comprehensive income for the year				568	217	785	16	801
Employee share options					67	67		67
– value of employee services					4	7		7
– proceeds from shares issued			3					
Dividends and other appropriations					(2,093)	(2,093)		(2,093)
– ordinary shares							(234)	(234)
– to non-controlling interests								
Purchase of own shares					(66)	(66)		(66)
– held in employee share ownership trusts					(12)	(12)		(12)
Non-controlling interests – acquisitions	29				26	26		26
Other movements								
Balance at 31 December 2010		506	3,910	1,600	3,190	9,206	342	9,548

The accompanying notes are an integral part of the Group financial statements

Group Balance Sheet

At 31 December

	Notes	2011 £m	2010 £m
Assets			
Non-current assets			
Intangible assets	9	11,992	12,458
Property, plant and equipment	10	3,047	3,117
Investments in associates and joint ventures	11	2,613	2,666
Retirement benefit assets	12	105	122
Deferred tax assets	13	343	411
Trade and other receivables	14	305	272
Available-for-sale investments	15	40	29
Derivative financial instruments	16	179	128
Total non-current assets		18,624	19,203
Current assets			
Inventories	17	3,498	3,608
Income tax receivable	18	127	73
Trade and other receivables	14	2,423	2,409
Available-for-sale investments	15	57	58
Derivative financial instruments	16	159	145
Cash and cash equivalents	19	2,194	2,329
		8,458	8,622
Assets classified as held-for-sale	26(c)	37	35
Total current assets		8,495	8,657
Total assets		27,119	27,860

Group Balance Sheet continued

	Notes	2011 £m	2010 £m
Equity			
Capital and reserves			
Share capital		506	506
Share premium, capital redemption and merger reserves		3,913	3,910
Other reserves		1,112	1,600
Retained earnings		2,636	3,190
Owners of the parent		8,167	9,206
after deducting			
– cost of treasury shares		(1,539)	(750)
Non-controlling interests		307	342
Total equity	20	8,474	9,548
Liabilities			
Non-current liabilities			
Borrowings	21	8,510	8,916
Retirement benefit liabilities	12	1,003	770
Deferred tax liabilities	13	556	509
Other provisions for liabilities and charges	22	458	187
Trade and other payables	23	184	193
Derivative financial instruments	16	87	92
Total non-current liabilities		10,798	10,667
Current liabilities			
Borrowings	21	1,766	1,334
Income tax payable	18	494	467
Other provisions for liabilities and charges	22	236	282
Trade and other payables	23	5,174	5,335
Derivative financial instruments	16	177	227
Total current liabilities		7,847	7,645
Total equity and liabilities		27,119	27,860

The accompanying notes are an integral part of the Group financial statements

On behalf of the Board



Richard Burrows
Chairman

22 February 2012

Group Cash Flow Statement

For the year ended 31 December

	Notes	2011 £m	2010 £m
Cash flows from operating activities			
Cash generated from operations	25	5,537	5,207
Dividends received from associates		476	461
Tax paid		(1,447)	(1,178)
Net cash used in operating activities		4,566	4,490
Cash flows from investing activities			
Interest received		79	59
Dividends received from investments		2	2
Purchases of property, plant and equipment		(510)	(497)
Proceeds on disposal of property, plant and equipment		45	61
Purchases of intangibles		(107)	(87)
Purchases and proceeds on disposals of investments	25	3	(1)
Proceeds from associates' share buy-backs	25	71	
Purchases of other subsidiaries and associates	25	(295)	
Proceeds on disposal of subsidiaries	25		12
Net cash used in investing activities		(712)	(451)
Cash flows from financing activities			
Interest paid		(580)	(578)
Interest element of finance lease rental payments			(2)
Capital element of finance lease rental payments		(13)	(17)
Proceeds from issue of shares to owners of the parent		3	3
Proceeds from the exercise of options over own shares held in employee share ownership trusts		2	4
Proceeds from increases in and new borrowings	25	1,361	892
Movements relating to derivative financial instruments	25	5	(179)
Purchases of own shares		(755)	
Purchases of own shares held in employee share ownership trusts		(123)	(66)
Purchases of non-controlling interests	25	(10)	(12)
Reductions in and repayments of borrowings	25	(1,304)	(1,582)
Dividends paid to owners of the parent	8	(2,358)	(2,093)
Dividends paid to non-controlling interests		(275)	(234)
Net cash used in financing activities		(4,047)	(3,864)
Net cash flows (used in)/from operating, investing and financing activities		(193)	175
Differences on exchange		(48)	29
(Decrease)/increase in net cash and cash equivalents in the year		(241)	204
Net cash and cash equivalents at 1 January		2,183	1,979
Net cash and cash equivalents at 31 December	19	1,942	2,183

The accompanying notes are an integral part of the Group financial statements

Notes on the accounts

1 Accounting policies

Basis of accounting

The Group financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union and with those parts of the Companies Act 2006 applicable to companies reporting under IFRS

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

The Group has not adopted any new and amended IFRS and IFRIC interpretations, that have had any significant effect on reported profit or equity or on the disclosures in the financial statements, with effect from 1 January 2011

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

The most significant items include

- the review of asset values, especially goodwill and impairment testing. The key assumptions used in respect of goodwill and impairment testing are the determination of cash-generating units, the long-term growth rate for cash flow projections and the rate used to discount the cash flow projections. These are described in note 9;
 - the estimation of and accounting for retirement benefit costs. The determination of the carrying value of assets and liabilities, as well as the charge for the year, and amounts recognised in other comprehensive income, involves judgments made in conjunction with independent actuaries. These involve estimates about uncertain future events based on the environment in different countries, including life expectancy of scheme members, salary and pension increases, inflation and expected returns on assets, as well as discount rates and asset values at the year end. The assumptions used by the Group and sensitivity analysis are described in note 12;
 - the estimation of amounts to be recognised in respect of taxation and legal matters, and the estimation of other provisions for liabilities and charges are subject to uncertain future events, may extend over several years and so the amount and/or timing may differ from current assumptions. The accounting policy for taxation is explained below and the recognised deferred tax assets and liabilities, together with a note of unrecognised amounts, are shown in note 6(b) and note 13. Other provisions for liabilities and charges are as set out in note 22. The accounting policy on contingent liabilities, which are not provided for, is set out below and the contingent liabilities of the Group are explained in note 30;
 - the definition of adjusting items, which are separately disclosed as memorandum information, is explained below and the impact of these on the calculation of adjusted earnings is described in note 7;
 - the estimation of the fair values of acquired net assets arising in a business combination under IFRS 3 Revised 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 2011 are described in note 26, and
- the exemptions taken under IFRS 1 on the first time adoption of IFRS at 1 January 2004 and, in particular, those relating to goodwill on business combinations which are explained in the accounting policies below

Such estimates and assumptions are based on historical experience and various other factors that are believed to be reasonable in the circumstances and constitute management's best judgment at the date of the financial statements. In the future, actual experience may deviate from these estimates and assumptions, which could affect the financial statements as the original estimates and assumptions are modified, as appropriate, in the year in which the circumstances change

Basis of consolidation

The consolidated financial information includes the financial statements of British American Tobacco plc and its subsidiary undertakings, together with the Group's share of the results of its associates and joint ventures

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

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

The results of subsidiary undertakings acquired during the period are included from the date of acquisition of a controlling interest at which date, for the purposes of consolidation, the purchase consideration is allocated between the underlying net assets acquired, including intangible assets other than goodwill, on the basis of their fair value. Acquisition related costs are expensed as incurred. Similarly, the results of associates and joint ventures are included from the date of acquiring significant influence or, in the case of joint ventures, joint control

The results of subsidiary undertakings, associates and joint ventures which have been sold during the year are included up to the date of disposal. The profit or loss on sale is calculated by reference to the net asset value at the date of disposal, adjusted for purchased goodwill previously consolidated in the balance sheet.

Inter-company balances and transactions, and any unrealised gains arising from inter-company transactions, are eliminated in preparing the consolidated financial statements

Foreign currencies

The functional currency of the Parent Company is sterling and this is also the presentation currency of the Group. The income and cash flow statements of Group undertakings expressed in currencies other than sterling are translated to sterling using exchange rates applicable to the dates of the underlying transactions. Average rates of exchange in each year are used where the average rate approximates the relevant exchange rate at the date of the underlying transactions. Assets and liabilities of Group undertakings are translated at the applicable rates of exchange at the end of each year. For hyperinflationary countries, the financial statements in local currency are adjusted to reflect the impact of local inflation prior to translation into sterling

The differences between retained profits of overseas subsidiary undertakings, associates and joint ventures translated at average and closing rates of exchange are taken to reserves, as are differences arising on the retranslation to sterling (using closing rates of exchange) of overseas net assets at the beginning of the year. Any differences that have arisen since 1 January 2004 are presented as a separate component

1 Accounting policies continued

of equity. As permitted under IFRS 1, any differences prior to that date are not included in this separate component of equity.

Where a disposal of an investment in a Group undertaking results in a loss of control of a subsidiary undertaking, the loss of significant influence over an associated company or the loss of joint control over a joint venture, the cumulative amount of the related foreign exchange differences deferred in the separate component of equity are recognised in the income statement when the gain or loss on disposal is recognised. These related exchange differences comprise the exchange differences on all amounts deemed to be part of the net investment in the undertaking, which are recycled to the income statement when a disposal occurs. For partial disposals of subsidiary undertakings the related exchange differences are reclassified within equity. For all other partial disposals the proportional share of the related exchange differences is recycled to the income statement.

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

Revenue

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

Retirement benefit costs

The Group operates both defined benefit and defined contribution schemes. The net deficit or surplus for each defined benefit pension scheme is calculated in accordance with IAS 19, based on the present value of the defined benefit obligation at the balance sheet date less the fair value of the scheme assets adjusted, where appropriate, for any surplus restrictions or the effect of minimum funding requirements.

Actuarial gains and losses, changes in unrecognised scheme surpluses and minimum funding requirements are recognised in full through other comprehensive income.

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

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

For defined benefit schemes, the actuarial cost charged to profit from operations consists of current service cost, interest cost, expected return on plan assets, past service cost and the impact of any settlements or curtailments.

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

Share-based payments

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

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

Research and development

Research expenditure is charged to income in the year in which it is incurred. Development expenditure is charged to income in the year it is incurred, unless it meets the recognition criteria of IAS 38 (Intangible Assets).

Taxation

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

The current income tax charge is calculated on the basis of tax laws enacted or substantially enacted at the balance sheet date in the countries where the Group's subsidiaries, associates and joint ventures operate and generate taxable income.

Deferred taxation is provided in full using the liability method for temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and the amount used for taxation purposes. Deferred tax is provided on temporary differences arising on investments in Group undertakings, except where the timing of the reversal of the temporary difference is controlled by the Group and it is probable that it will not reverse in the foreseeable future. A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. As required under IAS 12, 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

Notes on the accounts continued

1 Accounting policies continued

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 acquired by the Group's subsidiary undertakings and computer software.

Acquired trademarks are carried at cost less accumulated amortisation and impairment. Trademarks with indefinite lives are not amortised but are reviewed annually for impairment. Intangible assets other than goodwill classified as held-for-sale are not amortised. Other trademarks are amortised on a straight-line basis over their remaining useful lives, consistent with the pattern of economic benefits expected to be received, which do not exceed 20 years. Any impairments of trademarks are recognised in the income statement but increases in trademark values are not recognised.

Computer software is carried at cost less accumulated amortisation and impairment, and is amortised on a straight-line basis over periods ranging from three years to seven years.

The investments in associates and joint ventures shown in the Group balance sheet include trademarks arising from the combination of Brown & Williamson (B&W) and R J Reynolds (RJR) in 2004 to form Reynolds American Inc (RAI), as well as those arising on the acquisition of Conwood by RAI in 2006. As the combination of B&W and RJR for the Group involved the partial disposal of B&W and an investment in RAI, fair values were assigned to trademarks formerly owned by RJR but not to those formerly owned by B&W. Most of the carrying value of the trademarks relates to trademarks which are deemed to have indefinite lives and each trademark is subject to an annual impairment test. Certain minor trademarks are being amortised over their remaining lives.

Property, plant and equipment

Property, plant and equipment are stated at cost less accumulated depreciation and impairment. Depreciation is calculated on a straight-line basis to write off the assets over their useful economic life. No depreciation is provided on freehold land or assets classified as held for sale. Freehold and leasehold property are depreciated at rates between 2.5 per cent and 4 per cent per annum, and plant and equipment at rates between 7 per cent and 25 per cent 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 is on or after 1 January 2009, are capitalised as part of the cost of the asset, in accordance with IAS 23 Revised (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.

1 Accounting policies continued

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

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

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

Cash and cash equivalents. cash and cash equivalents include cash in hand and deposits held on call, together with other short-term highly liquid investments including investments in certain money market funds. Cash equivalents normally comprise instruments with maturities of three months or less at date of acquisition. In the cash flow statement, cash and cash equivalents are shown net of bank overdrafts, which are included as current borrowings in the liabilities section on the balance sheet.

Apart from available-for-sale investments, non-derivative financial assets are stated at amortised cost using the effective interest method, subject to reduction for allowances for estimated irrecoverable amounts. These estimates for irrecoverable amounts are recognised when there is objective evidence that the full amount receivable will not be collected according to the original terms of the asset. Such evidence might include financial difficulties of the debtor, defaults of payment or significant overdue balances. For interest-bearing assets, their carrying value includes accrued interest receivable. Available-for-sale investments are stated at fair value, with changes in fair value being recognised directly in other comprehensive income. When such investments are derecognised (e.g. through disposal) or become impaired, the accumulated gains and losses, previously recognised in other comprehensive income, are reclassified to the income statement within 'finance income'. Dividend and interest income on available-for-sale investments are included within 'finance income' when the Group's right to receive payments is established.

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

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

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

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

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

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

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

Dividends

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

Segmental analysis

The Group is organised and managed on the basis of its geographic regions. These are the reportable segments for the Group as they form the focus of the Group's internal reporting systems and are the basis used by the chief operating decision maker, identified as the Management Board, for assessing performance and allocating resources.

The Group is 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 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.

Notes on the accounts continued

1 Accounting policies continued

Adjusting items

Adjusting items are significant items in the profit from operations, net finance costs, taxation and the Group's share of the post-tax results of associates and joint ventures which individually or, if of a similar type, in aggregate, are relevant to an understanding of the Group's underlying financial performance. While the disclosure of adjusting items is not required by IFRS, these items are separately disclosed either as memorandum information on the face of the income statement and in the segmental analyses, or in the notes to the accounts as appropriate.

The Group believes that these items are useful to users of the Group financial statements in helping them to understand the underlying business performance and are used to derive the Group's principal non-GAAP measure which is adjusted diluted earnings per share.

Provisions

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

Contingent liabilities and contingent assets

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

Contingent assets are possible assets whose existence will only be confirmed by future events not wholly within the control of the entity and are not recognised as assets until the realisation of income is virtually certain.

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

Repurchase of share capital

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

Future changes to accounting policies

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

IFRS 9 Financial Instruments has been issued. This standard represents the first phase of the IASB's project to replace IAS 39 Financial Instruments Recognition and Measurement, and has mandatory application for accounting periods beginning on or after 1 January 2015. In its current form, it sets out the classification and measurement criteria for financial assets and financial liabilities. It requires all financial assets, including assets currently classified under IAS 39 as available-for-sale, to be measured at fair value through profit and loss unless the assets can be classified as held at amortised cost. Qualifying equity investments held at fair value may have their fair value changes taken through other comprehensive income by election. Where the fair value option for certain financial liabilities is applied, the portion of fair value changes representing own credit risk would be recognised through other comprehensive income rather than the income statement. The Group does not use the fair value option for financial liabilities. The effect of applying the standard in its current form is not considered to have a material impact on the Group's reported profit or equity. These changes have not been endorsed by the EU and will only become applicable once that endorsement has occurred.

A revised IAS 19 Employee Benefits has been issued and has mandatory application (subject to EU endorsement) from 1 January 2013. The new standard does not change the values of retirement benefit assets and liabilities on the balance sheet, but does change the amounts recognised in the income statement and in other comprehensive income. The expected return on plan assets and the interest cost on liabilities are replaced by a new component of the income statement charge – interest on the net retirement benefit asset / liability. In addition, prior service costs will no longer be deferred and will be recognised immediately. The revised standard has retrospective application. Had the standard been applied to the 2011 results profit for the year would have been approximately £54 million lower (2010: £47 million lower), with a compensating credit in other comprehensive income.

IFRS 10 Consolidated Financial Statements, IFRS 11 Joint Arrangements and IFRS 12 Disclosure of Interests in Other Entities have been issued along with revised versions of IAS 27 Separate Financial Statements and IAS 28 Associates, additionally IAS 31 Joint Ventures has been withdrawn. These standards form a single package of proposals with mandatory application from 1 January 2013 (subject to EU endorsement). 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 will potentially lengthen certain disclosures in respect of Group entities, the requirements of these standards are not expected to materially affect the Group.

An amendment to IAS 1 Presentation of Financial Statements has been issued. This amendment changes the disclosure of items presented in other comprehensive income grouping them into items which recycle to profit and loss and items which will not. Apart from the change in disclosure, this amendment will have little impact on the Group Accounts. Mandatory application (subject to EU endorsement) is for accounting periods beginning on or after 1 July 2012.

IFRS 13 Fair Value Measurement has been issued. This standard aims to provide a single source of fair value measurement and disclosure requirements for use across IFRS. The implementation of IFRS 13 does not change where fair value is or is not applied under IFRS and will not require a restatement of historical transactions. Mandatory application (subject to EU endorsement) is from 1 January 2013.

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.

As part of the plans to reduce complexity and drive efficiency in management structures and achieve a better balance in the scale of our regions, it was decided to reduce the management structure from five regions to four regions from 1 January 2011. Markets which comprised the Eastern Europe region were merged into the Africa and Middle East region and the Western Europe region. Russia, Ukraine, Moldova, Belarus, Caucasus and Central Asia form part of the new Eastern Europe, Middle East and Africa region (EEMEA), while Romania, Bulgaria, Serbia, Montenegro, Albania and Kosovo have become part of the Western Europe region. The comparatives have been restated according to the new management structure.

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 Management Board reviews current and prior year segmental revenue, adjusted profit from operations of subsidiaries and adjusted post-tax results of associates and joint ventures at constant rates of exchange. The constant rate comparison provided for reporting segment information is based on a retranslation, at prior year exchange rates, of the current year results of the Group's overseas entities but, other than in exceptional circumstances, does not adjust for transactional gains and losses in operations which are generated by movements in exchange rates. As a result, the 2011 segmental results were translated using the 2010 rates of exchange. The 2010 figures are also stated at the 2010 rates of exchange.

The analyses of revenue for the 12 months to 31 December 2011 and 31 December 2010, based on location of sales, are as follows:

	2011			Restated 2010
	Revenue Constant rates £m	Translation exchange £m	Revenue Current rates £m	Revenue £m
Asia-Pacific	4,150	101	4,251	3,759
Americas	3,574	(16)	3,558	3,498
Western Europe	3,532	68	3,600	3,695
EEMEA	4,206	(216)	3,990	3,931
Revenue	15,462	(63)	15,399	14,883

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:

	2011								Restated 2010
	Adjusted* segment result Constant rates £m	Translation exchange £m	Adjusted* segment result Current rates £m	Adjusting items £m	Segment result Current rates £m	Adjusted* segment result £m	Adjusting items £m	Segment result £m	Segment result £m
Asia-Pacific	1,480	59	1,539	(58)	1,481	1,332	(56)	1,276	1,276
Americas	1,440	1	1,441	(15)	1,426	1,382	(36)	1,346	1,346
Western Europe	1,204	24	1,228	(153)	1,075	1,103	(236)	867	867
EEMEA	1,362	(51)	1,311	(298)	1,013	1,167	(338)	829	829
	5,486	33	5,519	(524)	4,995	4,984	(666)	4,318	4,318
Fox River **				(274)	(274)				
Profit from operations	5,486	33	5,519	(798)	4,721	4,984	(666)	4,318	4,318
Net finance costs					(460)			(480)	(480)
Asia-Pacific	238	(13)	225	28	253	208	(9)	199	199
Americas	448	(16)	432	(17)	415	412	(63)	349	349
EEMEA	2		2		2	2		2	2
Share of post-tax results of associates and joint ventures	688	(29)	659	11	670	622	(72)	550	550
Profit before taxation					4,931			4,388	4,388

* The adjustments to profit from operations and the Group's share of the post-tax results of associates and joint ventures are explained in notes 3(e) to 3(h) and in note 5, respectively.

** The Fox River provision made in 2011 (see note 3(h)) has not been allocated to a segment or segments as it relates to a 1998 settlement agreement. It is presented separately from the segmental reporting which is used to evaluate segment performance and to allocate resources.

Notes on the accounts continued

2 Segmental analyses continued

Adjusted profit from operations at constant rates of £5,486 million (2010: £4,984 million) excludes certain impairment of intangibles and property, plant and equipment, as well as amortisation of trademarks. These are treated as adjusting items as explained in notes 3(b) and 3(e) to 3(g) and are excluded from segmental profit from operations at constant rates as follows

	2011					Restated 2010		
	Adjusted depreciation and amortisation Constant rates £m	Translation exchange £m	Adjusted depreciation and amortisation Current rates £m	Adjusting items comprising impairment and amortisation of trademarks £m	Depreciation, amortisation and impairment Current rates £m	Adjusted depreciation and amortisation £m	Adjusting items comprising impairment and amortisation of trademarks £m	Depreciation, amortisation and impairment £m
Asia-Pacific	105	1	106	31	137	98	26	124
Américas	127		127	5	132	107		107
Western Europe	101	2	103	55	158	129	104	233
EEMEA	116	(5)	111	279	390	108	325	433
	449	(2)	447	370	817	442	455	897

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

Revenue is based on location of sale	United Kingdom		All foreign countries		Group	
	2011 £m	2010 £m	2011 £m	2010 £m	2011 £m	2010 £m
External revenue	124	103	15,275	14,780	15,399	14,883

	United Kingdom		All foreign countries		Group	
	2011 £m	2010 £m	2011 £m	2010 £m	2011 £m	2010 £m
Intangible assets	173	110	11,819	12,348	11,992	12,458
Property, plant and equipment	188	159	2,859	2,958	3,047	3,117
Investments in associates and joint ventures			2,613	2,666	2,613	2,666

Included in the external revenue from foreign countries is £1,732 million (2010: £1,696 million) attributable to Brazil, being the only subsidiary contributing more than 10 per cent of the Group's external revenue in 2011 and 2010. The main acquisitions comprising the goodwill balance of £11,120 million (2010: £11,656 million) in intangible assets are provided in note 9. Included in investments in associates and joint ventures are amounts of £1,831 million (2010: £1,872 million) attributable to the investment in Reynolds American and £735 million (2010: £747 million) attributable to the investment in ITC. Further information can be found in note 11.

3 Profit from operations

(a) Employee benefit costs

	2011 £m	2010 £m
Wages and salaries	2,059	2,099
Social security costs	247	245
Other pension and retirement benefit costs (note 12)	98	119
Share-based payments – equity-settled (note 27)	76	67
Share-based payments – cash-settled (note 27)	21	20
	2,501	2,550

(b) Depreciation, amortisation and impairment costs

		2011 £m	2010 £m
Intangibles	– amortisation of trademarks (note 3(f))	58	62
	– amortisation of other intangibles	92	66
	– impairment	273	300
Property, plant and equipment	– depreciation	366	376
	– impairment	28	93
		817	897

Impairment of goodwill and trademarks is explained in note 3(g). Impairment in respect of certain other intangibles and property, plant and equipment are shown as part of restructuring costs (see note 3(e)).

(c) Other operating income

This represents operating income arising from the Group's activities which falls outside the definition of revenue and includes gains as a result of property disposals, service fees and other shared costs charged to third parties, manufacturing fees and trademark income.

Notes on the accounts continued

3 Profit from operations continued

(d) Other operating expenses include:

	2011 £m	Restated 2010 £m
Research and development expenses (excluding employee benefit costs and depreciation)	81	82
Exchange differences	38	62
Rent of plant and equipment (operating leases)		
– minimum lease payments	42	39
– sublease payments		1
Rent of property (operating leases)		
– minimum lease payments	85	84
– contingent rents		1
– sublease payments	2	2
Fees payable for audit services pursuant to legislation		
– fees payable to PricewaterhouseCoopers LLP for Parent Company and Group audit	17	18
– fees payable to other PricewaterhouseCoopers firms and associates for local statutory and Group reporting audits	80	79
Audit fees payable to PricewaterhouseCoopers firms and associates	97	97
Audit fees payable to other firms	04	04
Total audit fees payable	101	101
Fees payable to PricewaterhouseCoopers firms and associates for other services		
– other services pursuant to statutory legislation	02	02
– tax advisory services	38	56
– tax compliance	13	10
– services relating to information technology	02	21
– other non-audit services	04	05
	59	94

Research and development expenses for 2010 have been restated to include the costs related to Marketing Futures

The total fees payable to PricewaterhouseCoopers firms and associates included above are £15.6 million (2010: £19.1 million)

Total research and development costs including employee benefit costs and depreciation were £166 million (2010 restated: £164 million)

Other operating expenses also include the Fox River provision, which was made in 2011 and explained in note 30 (see page 182)

As a result of restrictions on accessing foreign exchange at the official exchange rate in Uzbekistan, the Group revalues monetary items, mostly comprising foreign currency payables, in its subsidiary in Uzbekistan at a more conservative rate. This rate represents the rate at which management expects to settle these items and resulted in the recognition of net exchange losses of £38 million in 2010. These were included in exchange differences of £62 million within other operating expenses in 2010.

(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. These initiatives include a review of the Group's manufacturing operations, 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:

	2011 £m	2010 £m
Employee benefit costs	100	163
Depreciation, amortisation and impairment costs	39	100
Other operating expenses	72	68
Other operating income	(18)	(20)
	193	311

3 Profit from operations continued

Restructuring and integration costs in 2011 principally relate to the continuation of factory closure and downsizing activities in Denmark and Australia respectively; a voluntary separation scheme and closure of the printing unit in Argentina, the closure of the Jawornik factory in Poland, the Tire factory in Turkey and the Lecce factory in Italy. The costs also cover the social plan and other closure activities relating to the Bremen factory closure in Germany and the integration of Productora Tabacalera de Colombia, S.A.S (Protabaco) into existing operations, including acquisition costs, as well as other restructuring initiatives directly related to improving the efficiency and effectiveness of the Group as a globally integrated enterprise. In addition, they also include separation packages in respect of permanent headcount reductions and permanent employee benefit reductions in the Group.

Restructuring and integration costs in 2010 principally relate to the continuation of factory closure and downsizing activities in Denmark and Australia respectively, the closure of the Jawornik factory in Poland, the Tire factory in Turkey and the Lecce factory in Italy. The costs also cover a voluntary separation scheme and closure of the printing unit in Argentina and the continued integration of Bentoel into existing operations, as well as other restructuring initiatives directly related to improving the efficiency and effectiveness of the Group as a globally integrated enterprise. These include the combining of the Group's businesses in Belgium, Luxembourg and the Netherlands and some other activities to reduce the overheads of the Group. In addition, the Group has recognised impairment charges as a result of the continued review of its software assets in light of the development of global software solutions.

Restructuring and integration costs in 2010 also include a payment of US\$21 million to Reynolds American relating to the early termination and settlement of all disputes at issue in respect of the Contract Manufacturing Agreement dated 30 July 2004, as explained in note 29.

Other operating income in 2011 includes gains from sale of surplus land and buildings in Argentina and the release of deferred income from a disposal in 2007. In 2010, other operating income also includes gains on property disposals and the release of deferred income from a disposal in 2007.

(f) Amortisation of trademarks

The acquisitions of Protabaco, Bentoel, Tekel and ST resulted in the capitalisation of trademarks which are amortised over their expected useful lives, which do not exceed 20 years. The amortisation charge of £58 million (2010: £62 million) is included in depreciation, amortisation and impairment costs in profit from operations.

(g) Impairment of goodwill and trademarks

During 2011, the Group impaired the remaining balance of the goodwill in respect of the Tekel acquisition in 2008, amounting to £273 million. This followed a goodwill and trademarks impairment of £249 million and £44 million respectively for the year ended 31 December 2010. Although cost saving initiatives in the acquisition plan have been delivered successfully, the impairment recognised in 2010 was calculated on the basis of no further significant excise increases. However, the Turkish Government announced a further increase effective from October 2011 and an additional increase effective from January 2013. The excise increases to date have resulted in the growth of illicit trade and a loss of volumes and market share and this is expected to continue. Turkey remains an important strategic market for the Group. The basis for determining the recoverable amounts of the goodwill and trademarks is explained in note 9.

(h) Fox River

A provision of £274 million has been made for a potential claim under a 1998 settlement agreement entered into by a Group subsidiary in respect of the clean up of sediment in the lower Fox River. This is explained in more detail in note 30 (see page 182).

Notes on the accounts continued

4 Net finance costs

	2011		2010	
	£m	£m	£m	£m
Finance costs				
– interest payable				
– bank borrowings	82		81	
– finance leases	1		2	
– facility fees	8		8	
– other	476		492	
		567		583
– fair value changes on derivative financial instruments		12		209
– exchange differences on financial liabilities		(2)		(285)
		577		507
Finance income				
– interest and dividend income				
– interest income in respect of available-for-sale investments			(1)	
– gains in respect of available-for-sale investments	(1)			
– dividend income in respect of available-for-sale investments	(2)		(2)	
– other interest income	(79)		(57)	
		(82)		(60)
– exchange differences on financial assets		(35)		33
		(117)		(27)
Net finance costs		460		480

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	9	16
– fair value hedging instruments – exchange related movements	4	(14)
– fair value hedging instruments – net interest income	(62)	(74)
– fair value hedging instruments – interest related movements (see note (i))	(51)	(75)
– fair value changes on hedged items – interest related movements (see note (i))	39	54
– instruments held-for-trading (note (ii))	73	302
	12	209
Finance costs – exchange differences on financial liabilities	(2)	(285)
Finance income – exchange differences on financial assets	(35)	33
	(25)	(43)

Notes

- (i) Hedge ineffectiveness in respect of fair value hedges is a £12 million gain (2010: £21 million gain) being the difference between the two items above.
- (ii) IFRS requires derivatives which do not meet the tests for hedge accounting under IAS 39 to be classified as instruments held-for-trading with fair value changes included in the income statement. These derivatives principally consist of other derivatives shown in note 16(d) and forward foreign currency contracts which have not been designated as hedges due to their fair value changes offsetting with other components of net finance costs relating to financial assets and liabilities.

Other interest payable includes interest on the bonds and notes detailed in note 21. Facility fees principally relate to the Group's central undrawn banking facility of £2 billion (2010: £2 billion), as well as the Group's €450 million term loan facility (2010: €450 million). Both facilities were renegotiated and agreed during December 2010 from £1.75 billion and €700 million respectively.

Exchange differences in respect of hedged items subject to fair value hedges and cash flow hedges were a gain of £4 million (2010: £14 million loss) and a gain of £9 million (2010: £16 million gain) respectively and are included in 'Finance costs – exchange differences' in the table above.

5 Associates and joint ventures

	2011		2010	
	Total £m	Group's share £m	Total £m	Group's share £m
Gross turnover (including duty, excise and other taxes)	12,841	4,864	12,834	4,924
Duty, excise and other taxes	(4,053)	(1,541)	(4,205)	(1,620)
Revenue	8,788	3,323	8,629	3,304
Profit from operations	2,861	1,066	2,473	938
Net finance costs	(149)	(62)	(152)	(63)
Profit on ordinary activities before taxation	2,712	1,004	2,321	875
Taxation on ordinary activities	(881)	(331)	(846)	(322)
Profit on ordinary activities after taxation	1,831	673	1,475	553
Attributable to				
Owners of parent company		670		550
Non-controlling interests		3		3
		673		553
Analysed as				
– adjusted share of post-tax results of associates and joint ventures		659		622
– issue of shares and change in shareholding	91	28	(30)	(9)
– smoking cessation programme	(55)	(23)		
– gain on disposal of business	51	22		
– Canadian settlements			(140)	(59)
– other	(37)	(16)	(10)	(4)
		670		550
Dividends				
– listed investments		479		460
– unlisted investments		7		6
		486		466

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 2011, the Group's interest in ITC decreased from 31.43 per cent to 31.04 per cent 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 £28 million, which is treated as a partial deemed disposal and included in the income statement.

During the year, Reynolds American, along with other tobacco companies, was refused by the US Supreme Court a request to revoke a 2009 order requiring them to finance a US\$278 million smoking cessation programme in Louisiana (Scott case). The Group's share of this charge amounts to £23 million (net of tax).

In March 2011, Reynolds American sold Lane Limited for US\$205 million in cash. The Group's share of the gain on the disposal of this business amounts to £22 million (net of tax).

Reynolds American has also recognised the following amounts which have been combined in the table of adjusting items and reported in other: Reynolds American reported a charge of US\$64 million in respect of four Engle progeny lawsuits that have proceeded through the appellate process in the state of Florida. The amount includes compensatory and punitive damages as well as attorneys' fees and statutory interest. The Group's share of this charge amounts to £10 million (net of tax). Reynolds American recognised trademark amortisation and impairment of US\$47 million and the Group's share of these charges amounts to £8 million (net of tax). Reynolds American reported US\$16 million and US\$11 million of tax credits and interest, respectively and the Group's share of these credits amounts to £6 million (net of tax). Reynolds American recognised restructuring charges of US\$23 million and the Group's share of these charges amounts to £4 million (net of tax).

Notes on the accounts continued

5 Associates and joint ventures continued

During 2010, the Group's interest in ITC decreased from 31.92 per cent to 31.43 per cent as a result of ITC issuing ordinary shares under the company's employee stock option scheme. This resulted in a charge of £9 million.

In the year ended 31 December 2010, a subsidiary of Reynolds American, R.J. Reynolds Tobacco Company Inc. (RJRTC), entered into a comprehensive settlement agreement with the Canadian federal, provincial and territorial governments to resolve all the governments' civil claims related to smuggling in Canada during the 1980s and 1990s. As part of the civil settlement, RJRTC agreed to pay the governments CA\$325 million. In a separate matter, a subsidiary of R.J. Reynolds Tobacco Holdings Inc., Northern Brands International Inc., entered into a plea agreement with the Ministry of the Attorney General of Ontario. As a result of its plea to one count of conspiracy to aid others in the sale and possession of contraband cigarettes in the early 1990s, Northern Brands paid a fine of CA\$75 million. The Group's share of these charges amounted to £59 million (net of tax).

In the year ended 31 December 2010, Reynolds American recognised the following amounts which have been combined in the table of adjusting items and reported in other Reynolds American recognised restructuring charges from the closure of one factory in August 2010 and the planned closure of another in mid 2011. As a result of these actions, Reynolds American recorded charges mostly relating to asset impairment and, to a lesser extent, severance costs. The Group's share of these charges amounted to £6 million (net of tax). RJRTC also received a payment of US\$21 million as a result of the agreement to terminate early the Contract Manufacturing Agreement dated 30 July 2004 between RJRTC and BATUS Japan Inc., a wholly owned Group subsidiary, and settle all disputes at issue between the parties as explained in note 29. The Group's share of this receipt amounted to £3 million (net of tax). In addition, Reynolds American recognised a trademark impairment charge of US\$6 million as well as trademark amortisation of US\$4 million. The Group's share of these charges amounted to £1 million (net of tax).

6 Taxation on ordinary activities

(a) Summary of taxation on ordinary activities

	2011 £m	2010 £m
UK corporation tax credit		(16)
Comprising		
– current year tax expense	14	16
– adjustments in respect of prior periods		(16)
– double taxation relief	(14)	(16)
Overseas tax	1,470	1,294
Comprising		
– current year tax expense	1,449	1,270
– adjustments in respect of prior periods	21	24
Total current tax	1,470	1,278
Deferred tax	86	(30)
Comprising		
– deferred tax relating to origination and reversal of temporary differences	84	(30)
– deferred tax relating to changes in tax rates	2	
	1,556	1,248

(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 & Customs in the Franked Investment Income Group Litigation Order (FIIGLO). There are 25 corporate groups in the FIIGLO. 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 be, and 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 need not have been paid. Claims for the repayment of UK tax incurred where the dividends were from the EU can be made back to 1973. The tentative conclusion reached by the High Court would, if upheld, produce an estimated receivable of about £1.2 billion for British American Tobacco.

6 Taxation on ordinary activities continued

The case was heard by the Court of Appeal in October 2009 and the judgment handed down on 23 February 2010. The Court of Appeal has determined that various questions 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. This time restriction would, if upheld, reduce the value of the claim to between zero and £10 million. Based on advice received, the Company believes it has realistic prospects of success on further appeal. The Company sought leave to appeal from the Supreme Court in the UK and the Supreme Court agreed to hear the appeal on time limits in February 2012.

Several questions were referred back to the ECJ for further clarification and a hearing took place in February 2012 at the ECJ. The courts' decisions are awaited.

No potential receipt has been recognised in the current year or the prior year, in the results of the Group, due to the uncertainty of the amounts and eventual outcome.

(c) Factors affecting the taxation charge

The taxation charge differs from the standard 26 per cent (2010: 28 per cent) rate of corporation tax in the UK. The major causes of this difference are listed below.

	2011		2010	
	£m	%	£m	%
Profit before tax	4,931		4,388	
Less: share of post-tax results of associates and joint ventures	(670)		(550)	
	4,261		3,838	
Tax at 26% (2010: 28%) on the above	1,108	26.0	1,075	28.0
Factors affecting the tax rate				
Tax at standard rates other than UK corporation tax rate	80	1.8	(4)	(0.1)
Other national tax charges	67	1.6	77	2.1
Permanent differences	155	3.6	(10)	(0.3)
Overseas withholding taxes	143	3.4	123	3.2
Double taxation relief on UK profits	(14)	(0.3)	(16)	(0.4)
Unutilised tax losses			(2)	(0.1)
Adjustments in respect of prior periods	21	0.5	8	0.2
Net deferred tax credits at other tax rates	(4)	(0.1)	(3)	(0.1)
	1,556	36.5	1,248	32.5

Following the goodwill impairment in Turkey as explained in note 3(g) and the uncertainty of future taxable profits, the Group has written off deferred tax assets of £43 million in Turkey in 2011 (2010: £35 million). This has been 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

	2011	2010
	£m	£m
Current tax	15	(23)
Deferred tax	5	24
Credited to other comprehensive income	20	1

The tax relating to each component of other comprehensive income is disclosed in note 20.

Notes on the accounts continued

7 Earnings per share

Basic earnings per share are based on profit for the year attributable to ordinary shareholders of £3,095 million (2010: £2,879 million) and 1,970 million (2010: 1,983 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 1,982 million (2010: 1,994 million) to reflect the potential dilutive effect of employee share schemes

	2011			2010		
	Earnings £m	Weighted average number of shares m	Earnings per share pence	Earnings £m	Weighted average number of shares m	Earnings per share pence
Basic earnings per share	3,095	1,970	157.1	2,879	1,983	145.2
Share options		12	(0.9)		11	(0.8)
Diluted earnings per share	3,095	1,982	156.2	2,879	1,994	144.4

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

	Notes	2011		Diluted 2010		2011		Basic 2010	
		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		3,095	156.2	2,879	144.4	3,095	157.1	2,879	145.2
Effect of restructuring and integration costs	3(e)	193	9.7	311	15.6	193	9.8	311	15.7
Tax and non-controlling interests on restructuring and integration costs		(45)	(2.3)	(75)	(3.8)	(45)	(2.3)	(75)	(3.8)
Effect of impairment of goodwill and trademarks	3(g)	273	13.8	293	14.7	273	13.9	293	14.8
Tax on impairment of goodwill and trademarks		(10)	(0.5)	(58)	(2.9)	(10)	(0.5)	(58)	(2.9)
Effect of deferred tax asset written off	6(c)	43	2.2	35	1.8	43	2.2	35	1.8
Effect of amortisation of trademarks	3(f)	58	2.9	62	3.1	58	2.9	62	3.1
Tax on amortisation of trademarks		(13)	(0.7)	(15)	(0.8)	(13)	(0.7)	(15)	(0.8)
Effect of Fox River	3(h)	274	13.8			274	13.9		
Effect of associates' adjusting items	5	(11)	(0.5)	72	3.6	(11)	(0.5)	72	3.6
Adjusted earnings per share		3,857	194.6	3,504	175.7	3,857	195.8	3,504	176.7

7 Earnings per share continued

Headline earnings per share as required by the JSE Limited

The presentation of headline earnings per share, as an alternative measure of earnings per share, is mandated under the JSE Listing Requirements. It is calculated in accordance with Circular 3/2009 'Headline Earnings', as issued by the South African Institute of Chartered Accountants. Headline earnings per share are calculated as shown below

	2011		Diluted 2010		2011		Basic 2010	
	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	3,095	156.2	2,879	144.4	3,095	157.1	2,879	145.2
Effect of impairment of intangibles and property, plant and equipment	301	15.2	393	19.7	301	15.3	393	19.8
Tax and non-controlling interests on impairment of intangibles and property, plant and equipment	(15)	(0.8)	(81)	(4.1)	(15)	(0.8)	(81)	(4.1)
Effect of gains on disposal of non-current assets held-for-sale	(15)	(0.8)	(16)	(0.8)	(15)	(0.8)	(16)	(0.8)
Tax and non-controlling interests on disposal of non-current assets held-for-sale	5	0.3	3	0.1	5	0.3	3	0.1
Effect of disposal of businesses and trademarks			(5)	(0.3)			(5)	(0.3)
Tax and non-controlling interests on disposal of businesses and trademarks			2	0.1			2	0.1
Effect of gains reclassified from the available-for-sale reserve	(1)	(0.1)			(1)	(0.1)		
Share of associates' trademark and other asset impairments net of tax	7	0.4	7	0.4	7	0.4	7	0.4
Share of associates' gains on disposal of assets held-for-sale net of tax	(26)	(1.3)			(26)	(1.3)		
Issue of shares and change in shareholding in associate	(28)	(1.4)	9	0.5	(28)	(1.4)	9	0.5
Headline earnings per share	3,323	167.7	3,191	160.0	3,323	168.7	3,191	160.9

An alternative measure of headline earnings per share has been presented below to take account of the effect of Fox River (note 3(h)), this measure is in addition to that mandated by the JSE Listing Requirements

Headline earnings per share amended for Fox River	3,597	181.5	3,191	160.0	3,597	182.6	3,191	160.9
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8 Dividends and other appropriations

	2011		2010	
	Pence per share	£m	Pence per share	£m
Ordinary shares				
Interim				
2011 paid 28 September 2011	38.1	738		
2010 paid 29 September 2010			33.2	662
Final				
2010 paid 5 May 2011	81.0	1,620	71.6	1,431
2009 paid 6 May 2010				
	119.1	2,358	104.8	2,093

The Directors have recommended to shareholders a final dividend of 88.4 pence per share for the year ended 31 December 2011. If approved, this dividend will be paid to shareholders on 3 May 2012. 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 £1,741 million, which takes the total dividends declared in respect of 2011 to £2,479 million (2010: £2,282 million) representing 126.5 pence per share (2010: 114.2 pence per share).

Notes on the accounts continued

9 Intangible assets

	Goodwill £m	Computer software £m	Trademarks and licences £m	Assets in the course of development £m	Total £m
1 January 2011					
Cost	11,656	551	802	83	13,092
Accumulated amortisation and impairment		(417)	(217)		(634)
Net book value at 1 January 2011	11,656	134	585	83	12,458
Differences on exchange	(397)	(4)	(30)	(3)	(434)
Additions					
– internal development		13		97	110
– acquisition of subsidiaries (see note 26(a))	134		121		255
– separately acquired		16	6		22
Reallocations		68	1	(69)	
Amortisation charge		(88)	(58)		(146)
Impairment	(273)				(273)
31 December 2011					
Cost	11,120	617	883	108	12,728
Accumulated amortisation and impairment		(478)	(258)		(736)
Net book value at 31 December 2011	11,120	139	625	108	11,992
1 January 2010					
Cost	11,331	502	806	63	12,702
Accumulated amortisation and impairment		(361)	(109)		(470)
Net book value at 1 January 2010	11,331	141	697	63	12,232
Differences on exchange	574	1	(9)	1	567
Additions					
– internal development		4		60	64
– separately acquired		12	5	7	24
Reallocations		48		(48)	
Amortisation charge		(64)	(64)		(128)
Impairment	(249)	(7)	(44)		(300)
Disposals		(1)			(1)
31 December 2010					
Cost	11,656	551	802	83	13,092
Accumulated amortisation and impairment		(417)	(217)		(634)
Net book value at 31 December 2010	11,656	134	585	83	12,458

Included in computer software and assets in the course of development are internally developed assets with a carrying value of £203 million (2010: £150 million). The costs of internally developed assets include capitalised expenses of employees working full time on software development projects, third party consultants, as well as software licence fees from third party suppliers.

Acquisitions of subsidiaries relate to the acquisition of Protabaco as explained in note 26(a).

Included in the net book value of trademarks and licences are trademarks relating to the acquisition of ST £367 million (2010: £412 million), Tekel £45 million (2010: £61 million) and Bentoel £80 million (2010: £94 million), as well as £119 million from the acquisition of Protabaco in 2011.

As a result of a loss of volumes in 2010, the Tekel trademarks were impaired by £44 million as explained in note 3(g). The recoverable amounts of the Tekel trademarks was determined on a value-in-use basis over their remaining useful economic lives applying the same assumptions used to determine the recoverable amount of the Group's Turkey cash-generating unit as described below.

9 Intangible assets continued

Impairment testing for intangible assets with indefinite lives including goodwill

Goodwill of £11,120 million (2010: £11,656 million) is included in intangible assets in the balance sheet of which the following are the significant acquisitions: Rothmans Group £4,947 million (2010: £5,176 million), Imperial Tobacco Canada £2,533 million (2010: £2,576 million), ETI (Italy) £1,377 million (2010: £1,412 million), ST (principally Scandinavia) £1,038 million (2010: £1,062 million) and Tekel (Turkey) £nil million (2010: £333 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.

As a consequence of the Group's new regional structure and the integrated nature of the activities, goodwill associated with the additional markets now part of the Western Europe region has been allocated to the Western Europe cash-generating unit, which was effective from 1 January 2011. Goodwill associated with markets now part of the new EEMEA region remains in the Eastern Europe cash-generating unit.

Due to initiatives to improve the effectiveness and the efficiency of the Group as a globally integrated enterprise and the integrated nature of the activities, the goodwill arising from the ST acquisition (principally Scandinavia) and ETI (Italy) have been transferred to the Western Europe cash-generating unit with effect from 1 January 2011.

In 2011, goodwill has been allocated for impairment testing purposes to 15 individual cash-generating units – five in Asia-Pacific, five in the Americas, two in Western Europe and three in EEMEA. In 2010, goodwill was allocated for impairment testing purposes to 16 individual cash-generating units – five in Asia-Pacific, four in the Americas, four in Western Europe and three in EEMEA.

The carrying amounts of goodwill allocated to the cash-generating units of Canada £2,533 million (2010: £2,576 million), Western Europe (includes Rothmans and other acquisitions) £3,646 million (2010: £3,726 million restated), Eastern Europe (includes Rothmans and other acquisitions) £914 million (2010: £931 million restated), South Africa £883 million (2010: £1,069 million), Australia (includes Rothmans and other acquisitions) £884 million (2010: £877 million), Singapore £530 million (2010: £532 million) and Malaysia £478 million (2010: £488 million) are considered significant in comparison with the total carrying amount of goodwill. As explained below, the goodwill in respect of Turkey, which was £333 million at 31 December 2010, has been fully impaired in 2011.

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 per cent. Cash flows for the years 3 to 10 are extrapolated from year 2 cash flows at 5 per cent per annum, including 2 per cent inflation, whereafter a total growth rate of 2 per cent per annum (including 2 per cent 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. The recoverable amount of the Turkey cash-generating unit has been determined on a value-in-use basis using a 10 year cash flow forecast with cash flows after year 10 extrapolated as described above. The impairment recognised in 2010 was calculated on the basis of no further significant excise increases. However, the Turkish government announced a further excise increase effective from October 2011 with an additional increase effective from January 2013. A ten year forecast is considered appropriate as this takes account of the expectation of sharp declines in volumes in 2012 and 2013, followed by gradual stabilisation and recovery. In addition, the forecast assumes no further increases in excise. As explained in note 3(g), although cost saving initiatives in the acquisition plan have been delivered successfully, as a direct result of the above, the remaining goodwill balance has been impaired by £273 million in 2011 (2010: £249 million). In 2011, there was no impairment of the trademarks in Turkey (2010: £44 million). Other than the impairment charge recognised in respect of Tekel goodwill, no other goodwill impairment charges were recognised in 2011 or 2010.

Pre-tax discount rates of between 7.2 per cent and 18.0 per cent (2010: 7.8 per cent to 18.7 per cent) were used, based on the Group's weighted average cost of capital, together with any premium applicable for 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 8.8 per cent for Canada (2010: 9.7 per cent), 8.6 per cent for Western Europe (2010: 9.3 per cent), 10 per cent for Eastern Europe (2010: 10.6 per cent), 10.8 per cent for South Africa (2010: 11.5 per cent), 8.6 per cent for Australia (2010: 9.3 per cent), 7.2 per cent for Singapore (2010: 7.8 per cent), 9.3 per cent for Malaysia (2010: 10.0 per cent) and 11.3 per cent for Turkey (2010: 11.9 per cent).

If discounted cash flows for cash-generating units should fall by 10 per cent, or the discount rate was increased at a post-tax rate of 1 per cent, there would be no further impairment.

Notes on the accounts continued

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 2011					
Cost	1,144	250	4,820	369	6,583
Accumulated depreciation and impairment	(467)	(109)	(2,890)		(3,466)
Net book value at 1 January 2011	677	141	1,930	369	3,117
Differences on exchange	(35)	(5)	(120)	(23)	(183)
Additions					
– separately acquired	16	6	132	348	502
– acquisition of subsidiaries (see note 26 (a))	22		32		54
Reallocations	16	11	287	(314)	
Depreciation	(26)	(12)	(316)		(354)
Impairment	(8)		(19)		(27)
Disposals	(8)	(1)	(32)		(41)
Net reclassifications as held-for-sale	(18)		(3)		(21)
31 December 2011					
Cost	1,069	256	4,588	380	6,293
Accumulated depreciation and impairment	(433)	(116)	(2,697)		(3,246)
Net book value at 31 December 2011	636	140	1,891	380	3,047
1 January 2010					
Cost	1,101	237	4,466	336	6,140
Accumulated depreciation and impairment	(421)	(95)	(2,614)		(3,130)
Net book value at 1 January 2010	680	142	1,852	336	3,010
Differences on exchange	34	3	80	21	138
Additions					
– separately acquired	20	6	137	354	517
Reallocations	30	5	307	(342)	
Depreciation	(30)	(7)	(344)		(381)
Impairment	(30)		(64)		(94)
Disposals	(3)	(8)	(37)		(48)
Net reclassifications as held-for-sale	(24)		(1)		(25)
31 December 2010					
Cost	1,144	250	4,820	369	6,583
Accumulated depreciation and impairment	(467)	(109)	(2,890)		(3,466)
Net book value at 31 December 2010	677	141	1,930	369	3,117
Assets held under finance leases					
31 December 2011					
Cost			35		35
Accumulated depreciation and impairment			(28)		(28)
Net book value at 31 December 2011			7		7
31 December 2010					
Cost		3	72		75
Accumulated depreciation and impairment		(2)	(56)		(58)
Net book value at 31 December 2010		1	16		17

10 Property, plant and equipment continued

The Group's finance lease arrangements relate principally to the lease of vending machines by the Group's Japanese subsidiary. Assets held under finance leases are secured under finance lease obligations included in note 21.

	2011 £m	2010 £m
Cost of freehold land within freehold property on which no depreciation is provided	84	98
Leasehold property comprises		
– net book value of long leasehold	106	106
– net book value of short leasehold	34	35
	140	141
Contracts placed for future expenditure	1	7

Bank borrowings are secured by property, plant and equipment to the value of £6 million (2010: £24 million)

11 Investments in associates and joint ventures

	2011 £m	2010 £m
1 January	2,666	2,521
Differences on exchange	(109)	105
Differences on exchange reclassified and reported in share of profit after taxation	(4)	(2)
Share of profit after taxation (note 5)	670	550
Dividends (note 5)	(486)	(466)
Actuarial losses relating to pensions and other post-retirement benefits (note 20)	(67)	(54)
Share buy-backs (note 25)	(71)	
Other equity movements	14	12
31 December	2,613	2,666
Non-current assets	4,119	4,278
Current assets	1,705	1,774
Non-current liabilities	(1,656)	(1,801)
Current liabilities	(1,555)	(1,585)
	2,613	2,666
Reynolds American Inc. (Group's share of market value £6,456 million (2010: £5,105 million))	1,831	1,872
ITC Ltd (Group's share of market value £5,886 million (2010: £6,020 million))	735	747
Other listed associates (Group's share of market value £65 million (2010: £44 million))	12	13
Unlisted	35	34
	2,613	2,666

The Group's share of non-current assets above include £1,503 million (2010: £1,508 million) of goodwill and £493 million (2010: £500 million) of trademarks arising from the Reynolds American transaction in 2004. As a result of the disposal of the Lane business in 2011, £17 million of goodwill arising from the Reynolds transaction in 2004 has been reported in the income statement. In addition, the non-current assets above include £669 million (2010: £664 million) of goodwill and £310 million (2010: £310 million) of trademarks arising from the acquisition of Conwood by Reynolds American 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, Reynolds American Inc. (RAI) group companies are named in litigation which does not involve Group companies. While it is impossible to be certain of the outcome of any particular case or of the amount of any possible adverse verdict, it is not impossible that the results of operations or cash flows of RAI, in particular quarterly or annual periods, could be materially affected by this and by the final outcome of any particular litigation. However, having regard to the contingent liability disclosures on litigation made by RAI in its public financial reports, the Directors are satisfied with the carrying value included above for RAI.

Notes on the accounts continued

11 Investments in associates and joint ventures continued

The Group's share of the RAI results for the year to 31 December 2011 includes £42 million (2010: £50 million) in respect of external legal fees and other external product liability defence costs

Additional information on associates is provided in the principal associate undertaking sections to the Annual Report.

12 Retirement benefit schemes

The Group's subsidiary undertakings operate around 175 retirement benefit arrangements worldwide. These arrangements have been developed in accordance with local practices in the countries concerned. The majority of scheme members belong to defined benefit schemes, most of which are funded externally and many of which are closed to new entrants. The Group also operates a number of defined contribution schemes.

The liabilities arising in the defined benefit schemes are determined in accordance with the advice of independent, professionally qualified actuaries, using the projected unit credit method. All schemes are formally valued at least every three years.

The principal pension schemes are in the UK, Germany, Canada, the Netherlands and Switzerland. Together these schemes account for over 85 per cent of the total obligations of the Group's defined benefit schemes.

In addition, the Group operates significant schemes in Canada which provide employees with certain other retirement benefits, such as healthcare. The liabilities in respect of these benefits are also assessed by qualified independent actuaries, applying the projected unit credit method.

The amounts recognised in the balance sheet are determined as follows:

	Pension schemes		Healthcare schemes		Total	
	2011 £m	2010 £m	2011 £m	2010 £m	2011 £m	2010 £m
Present value of funded scheme liabilities	(5,652)	(5,338)	(23)	(27)	(5,675)	(5,365)
Fair value of funded scheme assets	5,184	5,114	16	20	5,200	5,134
	(468)	(224)	(7)	(7)	(475)	(231)
Minimum funding obligations	(2)	(29)			(2)	(29)
Unrecognised funded scheme surpluses	(75)	(51)			(75)	(51)
	(545)	(304)	(7)	(7)	(552)	(311)
Present value of unfunded scheme liabilities	(197)	(174)	(149)	(163)	(346)	(337)
	(742)	(478)	(156)	(170)	(898)	(648)

The above net liability is recognised in the balance sheet as follows:

– retirement benefit scheme liabilities	(847)	(600)	(156)	(170)	(1,003)	(770)
– retirement benefit scheme assets	105	122			105	122
	(742)	(478)	(156)	(170)	(898)	(648)

The total accumulated net actuarial losses taken through other comprehensive income at 31 December 2011 were £1,155 million (2010: £693 million) for subsidiaries, and £417 million (2010: £350 million) net of tax for associates and joint ventures.

In Jamaica, the pension scheme holds shares in Carreras Group Ltd (a Group subsidiary) with a fair value of £6 million (2010: £6 million).

12 Retirement benefit schemes continued

The amounts recognised in the income statement are as follows.

	Pension schemes		Healthcare schemes		Total	
	2011 £m	2010 £m	2011 £m	2010 £m	2011 £m	2010 £m
Defined benefit schemes						
– current service cost	71	69	1	1	72	70
– interest cost	285	300	11	11	296	311
– expected return on scheme assets	(316)	(298)	(2)	(2)	(318)	(300)
– past service cost	9	4			9	4
– settlements and curtailments	(3)	(2)		(2)	(3)	(4)
	46	73	10	8	56	81
Defined contribution schemes	42	38			42	38
Total amount recognised in the income statement (note 3(a))	88	111	10	8	98	119

The above charges are recognised within employee benefit costs in 2011 and 2010 in note 3(a) and include a charge of £7 million in 2011 (2010: £2 million credit) in respect of pension costs reported as part of the restructuring costs charged in arriving at profit from operations (see note 3(e)).

The movements in scheme liabilities are as follows

	Pension schemes		Healthcare schemes		Total	
	2011 £m	2010 £m	2011 £m	2010 £m	2011 £m	2010 £m
Present value at 1 January	5,512	5,370	190	162	5,702	5,532
Differences on exchange	(89)	104	(7)	13	(96)	117
Current service cost	72	72	1	1	73	73
Interest cost	281	304	10	11	291	315
Past service costs – vested	8	4			8	4
Contributions by scheme members	3	3			3	3
Benefits paid	(336)	(327)	(9)	(9)	(345)	(336)
Settlements and curtailments	(5)	(5)		(2)	(5)	(7)
Acquisition of subsidiaries	1				1	
Actuarial losses/(gains)	402	(13)	(13)	14	389	1
Present value at 31 December	5,849	5,512	172	190	6,021	5,702
Funded schemes	5,652	5,338	23	27	5,675	5,365
Unfunded schemes	197	174	149	163	346	337
	5,849	5,512	172	190	6,021	5,702

The actuarial losses and gains in 2011 principally relate to changes in assumptions regarding discount rates and mortality, while in 2010 the actuarial gains and losses were offset by net experience gains.

Notes on the accounts continued

12 Retirement benefit schemes continued

The movements in funded scheme assets are as follows

	Pension schemes		Healthcare schemes		Total	
	2011 £m	2010 £m	2011 £m	2010 £m	2011 £m	2010 £m
Fair value of scheme assets at 1 January	5,114	4,618	20	16	5,134	4,634
Differences on exchange	(90)	93	(5)	3	(95)	96
Expected return on scheme assets	311	302	2	2	313	304
Company contributions	242	218	7	7	249	225
Contributions by scheme members	5	5			5	5
Benefits paid	(323)	(316)	(8)	(8)	(331)	(324)
Settlements	(2)				(2)	
Actuarial (losses)/gains	(73)	194			(73)	194
Fair value of scheme assets at 31 December	5,184	5,114	16	20	5,200	5,134

The actuarial gains and losses in both years principally relate to movements in the market value of scheme assets

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

Contributions in 2012 are expected to be £295 million for pension schemes and £7 million for healthcare schemes, compared to £242 million and £7 million, respectively, in 2011

	Pension schemes		Healthcare schemes		Total	
	2011 £m	2010 £m	2011 £m	2010 £m	2011 £m	2010 £m
Actual return on scheme assets	238	496	2	2	240	498

The movements in the unrecognised funded scheme surpluses are as follows

	Pension schemes		Healthcare schemes		Total	
	2011 £m	2010 £m	2011 £m	2010 £m	2011 £m	2010 £m
Unrecognised funded scheme surpluses at 1 January	(51)	(52)			(51)	(52)
Differences on exchange	1	(4)			1	(4)
Movement in year	(25)	5			(25)	5
Unrecognised funded scheme surpluses at 31 December	(75)	(51)			(75)	(51)

The movement in minimum funding obligations are as follows

	Pension schemes		Healthcare schemes		Total	
	2011 £m	2010 £m	2011 £m	2010 £m	2011 £m	2010 £m
Minimum funding obligations at 1 January	(29)	(75)			(29)	(75)
Differences on exchange		(7)				(7)
Movement in year	27	53			27	53
Minimum funding obligations at 31 December	(2)	(29)			(2)	(29)

Movements in unrecognised scheme surpluses and minimum funding obligations are recognised in other comprehensive income

12 Retirement benefit schemes continued

The principal actuarial assumptions (weighted to reflect individual scheme differences) used in the following principal countries are as follows

	UK %	Germany %	Canada %	Netherlands %	Switzerland %
31 December 2011					
Rate of increase in salaries	4.5	2.5	3.5	3.1	1.5
Rate of increase in pensions in payment	3.0	1.7	Nil	1.5	Nil
Rate of increase in deferred pensions	2.5	Nil	Nil	1.5	
Discount rate	4.7	5.0	4.0	4.7	3.0
General inflation	3.0	1.7	2.5	1.5	Nil

For healthcare inflation in Canada, the assumption is 8.5 per cent reducing to 5.0 per cent by 2018

For the remaining pension schemes, typical assumptions are that real salary increases will be from 0 per cent to 4.5 per cent per annum and discount rates will be from 0 per cent to 5.25 per cent above inflation. Pension increases, where allowed for, were generally assumed to be in line with inflation.

	UK %	Germany %	Canada %	Netherlands %	Switzerland %
31 December 2010					
Rate of increase in salaries	4.9	2.5	3.5	3.1	1.5
Rate of increase in pensions in payment	3.4	1.5	1.3	1.9	Nil
Rate of increase in deferred pensions	2.9	Nil	Nil	1.9	
Discount rate	5.4	4.8	4.7	5.1	3.0
General inflation	3.4	1.5	2.5	1.9	0.4

For healthcare inflation in Canada, the assumption was 9.0 per cent reducing to 5.0 per cent by 2018

For the remaining pension schemes, typical assumptions were that real salary increases will be from 0 per cent to 4 per cent per annum and discount rates will be from 1 per cent to 8 per cent above inflation. Pension increases, where allowed for, are generally assumed to be in line with inflation.

Discount rates are determined by reference to normal yields on high quality corporate bonds at the balance sheet date. For countries where there is not a deep market in such corporate bonds, the yield on government bonds is used.

Mortality assumptions are subject to regular review. In Canada, Germany, Switzerland and the Netherlands the same tables were used for both years. In Canada UP94 tables, in Germany Heubeck tables 2005G, in Switzerland EVK 2000 mortality tables and in the Netherlands AG Prognosetafel 2010-2060 mortality tables have been used. In the UK the SINA (year of birth) table with the Continuous Mortality Investigation (2009) model with a 1.5 per cent long term improvement rate, has been used. In 2010 the PXA92 (year of birth) table rated up two years for active and deferred members, with a 1.2 per cent underpin on future improvements and the PXA92 (year of birth) table rated up three years for current pensioners with no underpin on future improvements, all with the medium cohort effect were used.

Based on the above, the weighted average life expectancy, in years, for mortality tables used to determine benefit obligations is as follows

	UK		Germany		Canada		Netherlands		Switzerland	
	Male	Female	Male	Female	Male	Female	Male	Female	Male	Female
31 December 2011										
Member age 65 (current life expectancy)	22.5	24.7	18.5	22.6	19.7	22.1	19.9	24.6	18.9	21.4
Member age 45 (life expectancy at age 65)	24.7	27.1	21.2	25.1	21.2	22.9	21.3	24.8	21.7	23.9
31 December 2010										
Member age 65 (current life expectancy)	19.6	22.4	18.3	22.4	19.7	22.1	19.7	24.5	17.8	20.6
Member age 45 (life expectancy at age 65)	23.3	26.7	21.0	25.0	21.2	22.9	21.3	24.8	20.6	23.3

Notes on the accounts continued

12 Retirement benefit schemes continued

The expected rates of return on scheme assets in the following principal countries are as follows

	UK %	Germany %	Canada %	Netherlands %	Switzerland %
31 December 2011					
Equities	6.0	8.0	9.0	7.2	6.5
Bonds	3.8	5.0	4.0	3.7	2.4
Property		5.5		5.6	5.4
Other assets	6.0		Nil	4.0	5.2

For the remaining pension schemes, typical expected long-term real rates of return ranged from 0 per cent to 11 per cent.

	UK %	Germany %	Canada %	Netherlands %	Switzerland %
31 December 2010					
Equities	7.2	8.0	9.0	7.6	7.2
Bonds	4.8	5.0	4.0	4.2	2.7
Property	7.2	5.5		6.1	5.3
Other assets	7.2		Nil	4.0	1.7

For the remaining pension schemes, typical expected long-term real rates of return ranged from 1 per cent to 11 per cent.

Expected rates of return are determined taking into account the current level of expected returns on risk free investments, the historical level of risk premium associated with other invested assets, and the expectations for future returns on such assets

The major categories of assets as a percentage of the total fair value of scheme assets are as follows

	UK %	Germany %	Canada %	Netherlands %	Switzerland %	Others %	Total %
31 December 2011							
Equities	44.8	27.5	40.5	26.2	29.9	24.1	36.1
Bonds	50.9	29.0	53.3	64.6	44.2	56.2	50.1
Property		43.5		4.5	18.3	1.7	7.6
Other assets	4.3		6.2	4.7	7.6	18.0	6.2
31 December 2010							
Equities	53.9	33.6	40.7	29.7	32.0	23.8	40.6
Bonds	42.5	27.2	53.2	60.4	43.3	53.7	45.5
Property	2.0	39.2		5.3	17.3	1.7	8.3
Other assets	1.6		6.1	4.6	7.4	20.8	5.6

Other assets include hedge funds, cash, reinsurance contracts, other investments and recoverable taxes

12 Retirement benefit schemes continued

Valuation of post-retirement schemes involves judgments about uncertain future events. Sensitivities in respect of the key assumptions used to measure the principal pension schemes as at 31 December 2011 are set out below. These sensitivities show the hypothetical impact of a change in each of the listed assumptions in isolation, with the exception of the sensitivity to inflation which incorporates the impact of certain correlating assumptions such as salary increases. While each of these sensitivities holds all other assumptions constant, in practice such assumptions rarely change in isolation and the impacts may offset to some extent.

	1 year increase £m	1 year decrease £m	0.25 percentage point increase £m	0.25 percentage point decrease £m
Rate of mortality				
– (decrease)/increase in profit before taxation	(6)	7		
– increase/(decrease) of scheme liabilities	133	(134)		
Rate of inflation				
– (decrease)/increase in profit before taxation			(9)	9
– increase/(decrease) of scheme liabilities			134	(129)
Discount rate				
– increase/(decrease) in profit before taxation			2	(2)
– (decrease)/increase of scheme liabilities			(152)	166
Expected return on scheme assets				
– increase/(decrease) in profit before taxation			11	(11)

	2.5 percentage point increase £m	2.5 percentage point decrease £m
Market value of scheme assets		
– increase/(decrease) in profit before taxation	6	(6)
– increase/(decrease) of scheme assets	105	(105)

The effect on the profit before taxation reflects the impact on current service cost, interest cost and expected return on scheme assets where relevant, for 2012. The effect on scheme assets and liabilities is as at 31 December 2011.

A one percentage point change in healthcare inflation would have the following effects

	1 percentage point increase £m	1 percentage point decrease £m
31 December 2011		
Effect on total of current service cost and interest cost	2	(1)
Effect on healthcare scheme liabilities	22	(18)

The history of the present value of the scheme liabilities, fair value of the scheme assets, the scheme net deficits and experience gains and losses are as follows

	2011 £m	2010 £m	2009 £m	2008 £m	2007 £m
Historical information					
Scheme liabilities	6,021	5,702	5,532	4,895	4,497
Scheme assets	5,200	5,134	4,634	4,182	4,223
Scheme net deficits	(821)	(568)	(898)	(713)	(274)
Experience losses/(gains) on scheme liabilities	6	(191)	75	156	6
Experience losses/(gains) on scheme assets	73	(194)	(358)	857	94

Experience losses and gains on scheme liabilities are presented as part of actuarial gains and losses

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 £m	Fair value losses/(gains) £m	Other temporary differences £m	Total £m
At 1 January 2011	31	70	42	117	4	313	577
Differences on exchange (Charged)/credited to the income statement	(1)	(7)	(5)	(3)	(1)	(9)	(26)
Credited/(charged) to other comprehensive income	1	(36)	(20)	(7)	9	(49)	(102)
Subsidiaries acquired (note 26(a))	1		(1)	19	(7)	3	14
Other				2		1	3
At 31 December 2011	32	27	16	128	5	259	467
At 1 January 2010	33	62	51	109	6	268	529
Differences on exchange	1	2		6	(1)	13	21
Credited/(charged) to the income statement		(2)	28	(15)	(20)	13	4
Write-off of unutilised losses in Turkey (note 6(c))			(35)				(35)
Credited/(charged) to other comprehensive income			(2)	14	19	(9)	22
Other	(3)	8		3		28	36
At 31 December 2010	31	70	42	117	4	313	577

Deferred tax liabilities comprise

	Stock relief £m	Excess of capital allowances over depreciation £m	Undistributed earnings of associates and subsidiaries £m	Retirement benefits £m	Fair value (losses)/gains £m	Other temporary differences £m	Total £m
At 1 January 2011	12	195	166	117	2	183	675
Differences on exchange (Credited)/charged to the income statement	10	6	8	(3)		(37)	(16)
Charged to other comprehensive income				7		2	9
Subsidiaries acquired (note 26(a))		5				40	45
Other	(1)						(1)
At 31 December 2011	21	193	158	117	2	189	680
At 1 January 2010	8	215	161	117	1	204	706
Differences on exchange	1	7	6	(3)		1	12
(Credited)/charged to the income statement	6	(38)	(7)	7		(28)	(60)
(Credited) to other comprehensive income				(2)			(2)
Other	(3)	11	6	(2)	1	6	19
At 31 December 2010	12	195	166	117	2	183	675

	2011 £m	2010 £m
Net deferred tax liabilities	213	98

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

	2011 £m	2010 £m
Deferred tax assets	(343)	(411)
Deferred tax liabilities	556	509
	213	98

Deferred tax expected to be recovered within 12 months

	2011 £m	2010 £m
Deferred tax assets	(136)	(162)
Deferred tax liabilities	136	121
		(41)

At the balance sheet date, the Group has unused tax losses of £360 million (2010 £421 million) which have no expiry date and unused tax losses of £561 million (2010 £538 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 £1,184 million (2010 £795 million), which have no expiry date and £128 million, which will expire within the next 10 years.

At the balance sheet date, the Group has unused tax credits of £80 million (2010 £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 (2010 £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

	2011 £m	2010 £m
Trade receivables	1,857	1,831
Loans and other receivables	690	644
Prepayments and accrued income	181	206
	2,728	2,681
Current	2,423	2,409
Non-current	305	272
	2,728	2,681

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:

	2011 £m	2010 £m
Gross trade and other receivables	2,777	2,741
Allowance account	(49)	(60)
Net trade and other receivables per balance sheet	2,728	2,681

Notes on the accounts continued

14 Trade and other receivables continued

The movements in the allowance account are as follows

	2011 £m	2010 £m
1 January	60	71
Differences on exchange	(5)	3
Provided in the year	11	8
Amounts reversed during the year	(3)	(8)
Amounts in respect of receivables written-off	(14)	(14)
31 December	49	60

Impairment of trade receivables, including write offs and allowances, charged during the year is included as part of other operating expenses. For 2011, the net impairment charged was £11 million (2010: £3 million) of which £8 million (2010: £nil), is reflected in the above table.

As at 31 December 2011, trade and other receivables of £42 million (2010: £58 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:

	2011 £m	2010 £m
Less than three months	34	52
Between three and six months	3	4
Between six months and one year	3	2
Greater than one year	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:

	2011 £m	2010 £m
US dollar	127	126
UK sterling	112	108
Euro	32	29
Other currencies	36	39

Trade and other receivables also include certain interest bearing amounts and their effective interest rates are as follows:

	2011 £m	2010 £m	2011 %	2010 %
Euro	3	3	4.0	4.0
Other currencies	11	11	5.7	7.4

There is no material difference between the above amounts for trade and other receivables and their fair value due to the short-term duration of the majority of trade and other receivables. There is no concentration of credit risk with respect to trade receivables as the Group has a large number of internationally dispersed customers.

15 Available-for-sale investments

	2011 £m	2010 £m
1 January	87	83
Differences on exchange	(1)	(1)
Additions and advances	55	1
Revaluations	13	4
Disposals and repayments	(57)	
31 December	97	87
Current	57	58
Non-current	40	29
	97	87

The classification of these investments under the IFRS 7 fair value hierarchy is given in note 24

Investments have the following maturities

	As per balance sheet	
	2011 £m	2010 £m
Equity investments	40	30
Non-equity investments		
– within one year	46	44
– beyond one year and within two years	10	11
– beyond two years and within three years		1
– beyond five years	1	1
	97	87

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

	2011 £m	2010 £m
Functional currencies	82	83
US dollar	1	2
Other currencies	14	2
	97	87

Non-equity investments of £57 million (2010: £57 million) are principally denominated in UK sterling and have an effective interest rate of 5.1 per cent (2010: 1.4 per cent)

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 7 fair value hierarchy is given in note 24.

	2011		2010	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m
Fair value hedges				
– interest rate swaps	186	22	139	8
– cross-currency swaps	6	42	5	51
Cash flow hedges				
– cross-currency swaps		4		
– forward foreign currency contracts	44	85	36	96
Net investment hedges				
– forward foreign currency contracts	59	34	52	60
Cash flow hedges and net investment hedges				
– bifurcated cross-currency swaps			11	
Held-for-trading *				
– forward foreign currency contracts	34	63	21	92
– others	9	14	9	12
Total	338	264	273	319
Current	159	177	145	227
Non-current	179	87	128	92
	338	264	273	319
Derivatives				
– in respect of net debt	223	126	171	149
– other	115	138	102	170
	338	264	273	319

* 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.

16 Derivative financial instruments continued

For cash flow hedges, including bifurcated derivatives, the timing of expected cash flows is as follows

	2011		2010	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m
Within one year	41	82	75	77
Between one and two years	3	11	2	18
Between two and three years		4		1
	44	97	77	96
Less bifurcated derivatives designated as net investment hedges		(8)	(30)	
	44	89	47	96

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.

At 31 December 2010, the Group had a receive €465 million fixed rate, pay DKK 3,468 million fixed rate cross-currency swap which was bifurcated into a receive €465 million fixed rate pay £368 million fixed rate cross-currency swap designated as a cash flow hedge and a receive £368 million fixed rate pay DKK 3,468 million fixed rate cross-currency swap designated as a net investment hedge.

Following the maturity of the swap in 2011, the Group entered into a receive €467 million, pay DKK 3,470 million foreign exchange forward contract which has been bifurcated into a receive €467 million, pay £398 million foreign exchange forward contract designated as a cash flow hedge and a receive £398 million, pay DKK 3,470 million foreign exchange forward contract designated as a net investment hedge.

The above table includes the timing of expected cash flows on the bifurcated foreign exchange forward contract designated as a cash flow hedge and the cross-currency swap designated as a cash flow hedge for 2011 and 2010, respectively.

Notes on the accounts continued

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

	2011				2010			
	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	4,297	(4,177)	6,626	(6,788)	4,182	(4,075)	6,987	(7,219)
– cross-currency swaps	1		39	(26)	430	(419)	18	(8)
– other	1,188	(1,175)	1,174	(1,189)	1,379	(1,373)	1,371	(1,381)
Between one and two years								
– forward foreign currency contracts	293	(277)	348	(358)	167	(164)	364	(378)
– cross-currency swaps	1		68	(56)	1		18	(9)
Between two and three years								
– forward foreign currency contracts	6	(6)	55	(54)			39	(40)
– cross-currency swaps	1		183	(177)	1		18	(14)
Between three and four years								
– cross-currency swaps	1		36	(27)	1	(1)	18	(16)
Between four and five years								
– cross-currency swaps	1		361	(422)	1	(1)	18	(18)
Beyond five years								
– cross-currency swaps	19	(15)	592	(634)	20	(16)	343	(419)
	5,808	(5,650)	9,482	(9,731)	6,182	(6,049)	9,194	(9,502)

The maturity dates of net-settled derivative financial instruments are as follows

	2011		2010	
	Assets Inflow/ (Outflow) £m	Liabilities (Inflow)/ Outflow £m	Assets Inflow/ (Outflow) £m	Liabilities (Inflow)/ Outflow £m
Within one year	59	15	54	(1)
Between one and two years	58	10	40	(7)
Between two and three years	35	6	19	(2)
Between three and four years	14	3	15	1
Between four and five years	12	1	8	3
Beyond five years	18	(1)	22	32
	196	34	158	26

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

	2011		2010	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m
Interest rate swaps	186	22	139	8
Cross-currency swaps	6	46	16	51
Forward foreign currency contracts	137	182	109	248
Others	9	14	9	12
	338	264	273	319

16 Derivative financial instruments continued

(a) Interest rate swaps

								2011	
					Interest rate %		Assets £m	Liabilities £m	
Maturity date	Principal currency	m	£m	Original	Swapped				
Fixed to floating	2012	EUR	337	281	3.6	note (a)	7		
	2013	EUR	400	334	5.1	note (a)	24		
	2013	GBP	150	150	5.8	note (a)	10		
	2014	GBP	500	500	6.0	note (a)	29		
	2014	GBP	250	250	6.0	note (a)	22		
	2019	GBP	250	250	6.4	note (a)	64		
	2020	EUR	600	501	4.0	note (a)	30		
Floating to fixed	2017	EUR	600	501	note (a)	3.7		22	
							186	22	

								2010	
					Interest rate %		Assets £m	Liabilities £m	
Maturity date	Principal currency	m	£m	Original	Swapped				
Fixed to floating	2012	EUR	337	289	3.6	note (a)	14		
	2013	EUR	400	343	5.1	note (a)	31		
	2013	GBP	150	150	5.8	note (a)	12		
	2014	GBP	500	500	6.0	note (a)	20		
	2014	GBP	250	250	6.0	note (a)	20		
	2019	GBP	250	250	6.4	note (a)	39		
	2020	EUR	600	514	4.0	note (a)		8	
Floating to fixed	2017	EUR	600	514	note (a)	3.7	3		
							139	8	

Note (a) The floating rate interest rates are based on LIBOR (or local equivalent) plus a margin ranging between 35 and 268 basis points.

These swaps have been used to manage the interest rate profile of external borrowings and are reflected in the repricing table in note 21

(b) Cross-currency swaps

											2011	
		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	395		30
		2019	EUR	4.6	20	17	USD	note (b)	22	14	6	
		2021	EUR	3.6	600	501	GBP	note (b)	518	518		12
Floating to fixed		2014	USD	note (b)	261	168	COP	7.2	504,158	167		4
											6	46

											2010	
		Maturity date	Original currency	Interest rate %	Principal original currency m	£m	Swapped currency	Interest rate %	Principal swapped currency m	£m	Assets £m	Liabilities £m
Fixed to fixed		2011	EUR	5.9	465	398	DKK	6.2	3,468	399	11	
Fixed to floating		2016	GBP	5.5	325	325	EUR	note (b)	473	405		51
		2019	EUR	4.6	20	17	USD	note (b)	22	14	5	
											16	51

Note (b): The floating rate interest rates are based on LIBOR (or local equivalent) plus a margin ranging between 82 and 250 basis points (2010: between 82 and 83 basis points).

Notes on the accounts continued

16 Derivative financial instruments continued

(c) Forward foreign currency contracts

Forward foreign currency contracts are denominated in the following currencies

Fair values of assets

	2011					2010					
	GBP £m	USD £m	EUR £m	BRL £m	Others £m	Total £m	GBP £m	USD £m	EUR £m	Others £m	Total £m
Currencies sold forward											
CHF	12		1			13					
EUR	38	21			1	60	11	10		4	25
GBP		9			5	14		5	10	14	29
HUF	4		2			6					
PLN	1		5			6					
RUR	1	3				4					
USD	2					2	36		2	7	45
ZAR	19	1			1	21					
Other currencies	6	4	1			11	6	1	2	1	10
	83	38	9		7	137	53	16	14	26	109

Fair values of liabilities

	2011					2010					
	GBP £m	USD £m	EUR £m	BRL £m	Others £m	Total £m	GBP £m	USD £m	EUR £m	Others £m	Total £m
Currencies sold forward											
AUD	28		1			29	37	6	1		44
BRL								4			4
CAD	5				2	7	15	2			17
CHF	2		4			6	24		9		33
EUR	2				8	10	27	6		1	34
GBP		1	10			11		6	2		8
JPY		41				41		52			52
NOK			2			2			4		4
SEK			5			5			2		2
USD	41		7	11	2	61	13		1		14
ZAR	3					3	22		1		23
Other currencies	4	1	2			7	8	2	2	1	13
	85	43	31	11	12	182	146	78	22	2	248

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.

Certain contracts were used to manage the currency profile of external borrowings and are reflected in the currency table in note 21, and their nominal values are as follows

	2011		2010	
	Purchase £m	Sell £m	Purchase £m	Sell £m
Forward contracts to purchase GBP, sell CHF	(89)	86	(181)	189
Forward contracts to purchase GBP, sell CAD	(290)	294	(292)	299
Forward contracts to purchase GBP, sell AUD	(1,092)	1,121	(1,074)	1,048
Forward contracts to purchase GBP, sell USD	(268)	272		
Forward contracts to purchase EUR, sell DKK	(390)	390		
Forward contracts to purchase EUR, sell SEK	(126)	130	(130)	132
Forward contracts to purchase EUR, sell NOK	(160)	162	(160)	164
Forward contracts to purchase EUR, sell GBP	(75)	77	(372)	367

(d) Others

	2011		2010	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m
Others Bund forwards (note (i))	9	11	5	7
Interest derivative (note (ii))		3		5
Sinking fund policy (note (iii))			4	
	9	14	9	12

Notes

- (i) Forward contracts to purchase and sell German government securities with a nominal value of €1.4 billion (2010: €1.6 billion) taken out to manage internal financing arrangements and maturing within one year
- (ii) Remaining impact of an interest derivative with a nominal value of €1 billion maturing in 2013
- (iii) Investment in sinking fund policy with a nominal value of ZAR1 million (2010: ZAR33 million)

17 Inventories

	2011 £m	2010 £m
Raw materials and consumables	1,797	1,893
Finished goods and work in progress	1,477	1,531
Goods purchased for resale	224	184
	3,498	3,608

Inventories pledged as security for liabilities amount to £13 million (2010: £17 million). Write-offs taken to other operating expenses in the Group income statement comprise £38 million (2010: £45 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 2011 and 2010.

Notes on the accounts continued

19 Cash and cash equivalents

	2011 £m	2010 £m
Cash and bank balances	970	943
Cash equivalents	1,224	1,386
	2,194	2,329

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.

	2011 £m	2010 £m
Functional currency	1,404	2,131
US dollar	678	102
UK sterling	14	10
Euro	30	14
Other currencies	68	72
	2,194	2,329

At 31 December 2011, cash and cash equivalents of £1 million (2010: £nil) were pledged as collateral.

In the Group cash flow statement, net cash and cash equivalents are shown after deducting bank overdrafts and accrued interest, as follows:

	2011 £m	2010 £m
Cash and cash equivalents as above	2,194	2,329
Less:		
– accrued interest		(1)
– overdrafts	(252)	(145)
Net cash and cash equivalents	1,942	2,183

Cash and cash equivalents include restricted amounts of £146 million (2010: £82 million), principally due to exchange control regulations in certain countries.

20 Capital and reserves – reconciliation of movement in total equity

	Attributable to owners of the parent						Total equity £m
	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	
1 January 2011	506	3,910	1,600	3,190	9,206	342	9,548
Comprehensive income and expense							
Profit for the year				3,095	3,095	280	3,375
Differences on exchange							
– subsidiaries			(377)		(377)	(34)	(411)
– associates			(109)		(109)		(109)
Differences on exchange reclassified and reported in profit for the year			(4)		(4)		(4)
Cash flow hedges							
– net fair value losses			(19)		(19)	(2)	(21)
– reclassified and reported in profit for the year			38		38		38
– reclassified and reported in net assets			(5)		(5)		(5)
Available-for-sale investments							
– net fair value gains			26		26		26
– reclassified and reported in profit for the year			(1)		(1)		(1)
Net investment hedges							
– net fair value gains			62		62		62
– differences on exchange on borrowings			(104)		(104)		(104)
Retirement benefit schemes							
– actuarial losses in respect of subsidiaries (note 12)				(461)	(461)	(1)	(462)
– surplus recognition and minimum funding obligations in respect of subsidiaries (note 12)				3	3	(1)	2
– actuarial losses in respect of associates net of tax (note 11)				(67)	(67)		(67)
Tax on other items recognised directly in other comprehensive income (note 6(d))			5	12	17	3	20
Other changes in equity							
Employee share options							
– value of employee services				76	76		76
– proceeds from shares issued		3		2	5		5
Dividends and other appropriations							
– ordinary shares				(2,358)	(2,358)		(2,358)
– to non-controlling interests						(279)	(279)
Purchase of own shares							
– held in employee share ownership trusts				(123)	(123)		(123)
– share buy-back programme				(755)	(755)		(755)
Non-controlling interests – acquisitions				(10)	(10)		(10)
Other movements				32	32	(1)	31
31 December 2011	506	3,913	1,112	2,636	8,167	307	8,474

Notes on the accounts continued

20 Capital and reserves – reconciliation of movement in total equity continued

	Attributable to owners of the parent						Total equity £m
	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	
1 January 2010	506	3,907	1,032	2,168	7,613	299	7,912
Comprehensive income and expense							
Profit for the year				2,879	2,879	261	3,140
Differences on exchange							
– subsidiaries			484		484	18	502
– associates			105		105		105
Differences on exchange reclassified and reported in profit for the year			(3)		(3)		(3)
Cash flow hedges							
– net fair value losses			(106)		(106)		(106)
– reclassified and reported in profit for the year			55		55		55
– reclassified and reported in net assets			3		3		3
Available-for-sale investments							
– net fair value gains			4		4		4
Net investment hedges							
– net fair value losses			(31)		(31)		(31)
– differences on exchange on borrowings			71		71	3	74
Retirement benefit schemes							
– actuarial gains/(losses) in respect of subsidiaries (note 12)				198	198	(5)	193
– surplus recognition and minimum funding obligations in respect of subsidiaries (note 12)				57	57	1	58
– actuarial losses in respect of associates net of tax (note 11)				(54)	(54)		(54)
Tax on other items recognised directly in other comprehensive income (note 6(d))			(14)	16	2	(1)	1
Other changes in equity							
Employee share options							
– value of employee services				67	67		67
– proceeds from shares issued		3		4	7		7
Dividends and other appropriations							
– ordinary shares				(2,093)	(2,093)		(2,093)
– to non-controlling interests						(234)	(234)
Purchase of own shares							
– held in employee share ownership trusts				(66)	(66)		(66)
Non-controlling interests – acquisitions				(12)	(12)		(12)
Other movements				26	26		26
31 December 2010	506	3,910	1,600	3,190	9,206	342	9,548

Details relating to the allotted share capital, and movements therein, are included in note 4 of the Parent Company financial statements

20 Capital and reserves – reconciliation of movement in total equity continued

Share premium account, capital redemption reserves and merger reserves comprise

	Share premium account £m	Capital redemption reserves £m	Merger reserves £m	Total £m
1 January 2010	58	101	3,748	3,907
31 December 2010	61	101	3,748	3,910
31 December 2011	64	101	3,748	3,913

The share premium account includes the difference between the value of shares issued and their nominal value. The increase of £3 million (2010: £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 £1,278 million (2010: £523 million) for shares repurchased and not cancelled and £261 million (2010: £227 million) in respect of the cost of own shares held in employee share ownership trusts.

Transaction costs deducted from equity for the year ended 31 December 2011 were £5 million (2010: £nil).

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.

Notes on the accounts continued

20 Capital and reserves – reconciliation of movement in total equity continued

Movements in other reserves and retained earnings (which is after deducting treasury shares) shown above comprise

	Translation reserve £m	Hedging reserve £m	Available- for-sale reserve £m	Revaluation reserve £m	Other £m	Total other reserves £m	Retained earnings	
							Treasury shares £m	Other £m
1 January 2011	868	(35)	15	179	573	1,600	(750)	3,940
Comprehensive income and expense								
Profit for the year								3,095
Differences on exchange								
– subsidiaries	(377)					(377)		
– associates	(109)					(109)		
Differences on exchange reclassified and reported in profit for the year	(4)					(4)		
Cash flow hedges								
– net fair value losses		(19)				(19)		
– reclassified and reported in profit for the year		38				38		
– reclassified and reported in net assets		(5)				(5)		
Available-for-sale investments								
– net fair value gains			26			26		
– reclassified and reported in profit for the year			(1)			(1)		
Net investment hedges								
– net fair value gains	62					62		
– differences on exchange on borrowings	(104)					(104)		
Retirement benefit schemes								
– actuarial losses in respect of subsidiaries (note 12)								(461)
– surplus recognition and minimum funding obligations in respect of subsidiaries (note 12)								3
– actuarial losses in respect of associates net of tax (note 11)								(67)
Tax on items recognised directly in other comprehensive income (note 6(d))	13	(8)				5		12
Other changes in equity								
Employee share options								
– value of employee services								76
– proceeds from shares issued							2	
Dividends and other appropriations								
– ordinary shares								(2,358)
Purchase of own shares								
– held in employee share ownership trusts							(123)	
– share buy-back programme							(755)	
Non-controlling interests – acquisitions								(10)
Other movements							87	(55)
31 December 2011	349	(29)	40	179	573	1,112	(1,539)	4,175

20 Capital and reserves – reconciliation of movement in total equity continued

	Translation reserve £m	Hedging reserve £m	Available-for-sale reserve £m	Revaluation reserve £m	Other £m	Total other reserves £m	Retained earnings	
							Treasury shares £m	Other £m
1 January 2010	275	(6)	11	179	573	1,032	(772)	2,940
Comprehensive income and expense								
Profit for the year								2,879
Differences on exchange								
– subsidiaries	484					484		
– associates	105					105		
Differences on exchange reclassified and reported in profit for the year	(3)					(3)		
Cash flow hedges								
– net fair value losses		(106)				(106)		
– reclassified and reported in profit for the year		55				55		
– reclassified and reported in net assets		3				3		
Available-for-sale investments								
– net fair value gains			4			4		
Net investment hedges								
– net fair value losses	(31)					(31)		
– differences on exchange on borrowings	71					71		
Retirement benefit schemes								
– actuarial gains in respect of subsidiaries (note 12)								198
– surplus recognition and minimum funding obligations in respect of subsidiaries (note 12)								57
– actuarial losses in respect of associates net of tax (note 11)								(54)
Tax on items recognised directly in other comprehensive income (note 6(d))	(33)	19				(14)		16
Other changes in equity								
Employee share options								
– value of employee services								67
– proceeds from shares issued							4	
Dividends and other appropriations								
– ordinary shares								(2,093)
Purchase of own shares								
– held in employee share ownership trusts							(66)	
Non-controlling interests – acquisitions							84	(12)
Other movements								(58)
31 December 2010	868	(35)	15	179	573	1,600	(750)	3,940

The translation reserve is as explained in the accounting policy on foreign currencies in note 1

The hedging reserve and the available-for-sale reserve are as explained in the accounting policy on financial instruments in note 1

The revaluation reserve relates to the acquisition of the cigarette and snus business of ST in 2008

Of the amounts released from the hedging reserve during the year, losses of £5 million (2010: £4 million) and losses of £26 million (2010: £38 million) were reported within revenue and raw materials and consumables respectively, together with a gain of £2 million (2010: £3 million) reported in other operating expenses and a loss of £9 million (2010: £16 million) reported within net finance costs

Notes on the accounts continued

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

	2011 £m	2010 £m
Translation reserve		
Differences on exchange	7	(4)
Net investment hedges		
– difference on exchange on borrowings	6	(29)
	13	(33)
Hedging reserve		
Cash flow hedges		
– net fair value losses	8	27
– reclassified and reported in profit for the year	(16)	(8)
	(8)	19
Retained earnings		
– actuarial (losses)/gains in respect of subsidiaries	13	31
– surplus recognition and minimum funding obligations in respect of subsidiaries	(1)	(15)
	12	16
Owners of the parent	17	2
Non-controlling interests	3	(1)
Total tax recognised in other comprehensive income for the period (note 6(d))	20	1

21 Borrowings

	Currency	Maturity dates	Interest rates	2011 £m	2010 £m
Eurobonds	Euro	2011 to 2021	3.6% to 5.9%	4,985	5,064
	UK sterling	2013 to 2040	5.5% to 7.3%	2,675	2,626
Bonds issued pursuant to Rule 144A and RegS under the US Securities Act (as amended)	US dollar	2013 to 2018	8.1% to 9.5%	643	637
Other notes	Malaysian ringgit	2012 to 2014	4.1% to 4.5%	134	136
	Indonesian rupiah	2012	10.5%	96	96
	Other currencies			26	26
Syndicated bank loans	US dollar	2012	floating rate	444	442
	Euro	2013	floating rate	374	382
Commercial paper				85	
Bank loans				497	629
Other loans				57	47
Finance leases				8	20
Overdrafts				252	145
				10,276	10,250

The floating interest rates referred to in the table above are based on EURIBOR or USD LIBOR plus a margin ranging between 28 and 105 basis points (2010: 28 and 105 basis points)

	2011 £m	2010 £m
Current	1,766	1,334
Non-current	8,510	8,916
	10,276	10,250

Current borrowings include interest payable of £230 million at 31 December 2011 (2010: £242 million) included within borrowings are £3,066 million (2010: £2,595 million) of borrowings subject to fair value hedges where their amortised cost has been increased by £189 million (2010: £150 million) in the table above

The fair value of borrowings is estimated to be £11,263 million (2010: £10,963 million) and has been determined using quoted market prices or discounted cash flow analysis

	2011 £m	2010 £m
Amounts secured on Group assets	27	61

Amounts secured on Group assets include finance leases of £8 million (2010: £20 million) The remaining amounts are secured on certain property and inventory of the Group (note 10 and note 17)

Borrowings are repayable as follows

	Per balance sheet		Contractual gross maturities	
	2011 £m	2010 £m	2011 £m	2010 £m
Within one year	1,766	1,334	1,922	1,389
Between one and two years	1,228	1,057	1,602	1,382
Between two and three years	665	1,232	1,086	1,740
Between three and four years	1,042	617	1,417	1,021
Between four and five years	454	1,067	767	1,430
Beyond five years	5,121	4,943	6,978	7,061
	10,276	10,250	13,772	14,023

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

Notes on the accounts continued

21 Borrowings continued

Borrowings are denominated in the functional currency of the subsidiary undertaking or other currencies as shown below

	Functional currency £m	US dollar £m	UK sterling £m	Euro £m	Canadian dollar £m	Australian dollar £m	Other currencies £m	Total £m
31 December 2011								
Total borrowings	5,213	1,264	329	3,431	1		38	10,276
Effect of derivative financial instruments								
– cross-currency swaps	1,080	(154)	(325)	(518)				83
– forward foreign currency contracts	(1,662)	272		(751)	294	1,121	768	42
	4,631	1,382	4	2,162	295	1,121	806	10,401
31 December 2010								
Total borrowings	5,111	1,277	329	3,524	1		8	10,250
Effect of derivative financial instruments								
– cross-currency swaps		14	(325)	(10)			399	78
– forward foreign currency contracts	(1,180)			(662)	299	1,048	485	(10)
	3,931	1,291	4	2,852	300	1,048	892	10,318

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 2011							
Total borrowings	2,373	848	598	1,042	324	5,091	10,276
Effect of derivative financial instruments							
– interest rate swaps	1,484	(484)	(750)			(250)	
– cross-currency swaps	759		167		(325)	(518)	83
	4,616	364	15	1,042	(1)	4,323	10,359
31 December 2010							
Total borrowings	2,179	616	851	617	1,067	4,920	10,250
Effect of derivative financial instruments							
– interest rate swaps	1,782	(289)	(493)	(750)		(250)	
– cross-currency swaps	419					(342)	77
	4,380	327	358	(133)	1,067	4,328	10,327

Details of the derivative financial instruments included in these tables are given in note 16

21 Borrowings continued

Finance lease liabilities per the balance sheet and on a contractual gross maturity basis are payable as follows

	2011			2010		
	Principal £m	Interest £m	Total £m	Principal £m	Interest £m	Total £m
Within one year	4		4	11	1	12
Between one and two years	1		1	5		5
Between two and three years	1		1	2		2
Between three and four years	1		1	1		1
Between four and five years	1		1			
Beyond five years				1		1
	8		8	20	1	21

Borrowings facilities – undrawn committed facilities expire as follows

	2011 £m	2010 £m
Within one year	194	282
Between one and two years	10	
Between two and three years		
Between three and four years	2,000	
Between four and five years		2,000
	2,204	2,282

In December 2010 the Group negotiated a new central banking facility of £2 billion with a final maturity date of December 2015. The existing central banking facility of £1.75 billion, with a final maturity date of March 2012, was cancelled at the same time.

The Group defines net debt as follows

	2011 £m	2010 £m
Borrowings (note 21)	10,276	10,250
Derivatives in respect of net debt		
– assets (note 16)	(223)	(171)
– liabilities (note 16)	126	149
Cash and cash equivalents (note 19)	(2,194)	(2,329)
Current available-for-sale investments (note 15)	(57)	(58)
	7,928	7,841

Notes on the accounts continued

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 2011	207	48		214	469
Differences on exchange	(8)	(2)		(16)	(26)
Subsidiaries acquired		5		9	14
Provided in respect of the year	52	5	274	61	392
Utilised during the year	(91)	(6)		(48)	(145)
Other movements	(11)			1	(10)
31 December 2011	149	50	274	221	694
Analysed on the Balance Sheet as					
– current	77	22		137	236
– non-current	72	28	274	84	458
	149	50	274	221	694

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 2011 and 2010 are as described in note 3(e). While some elements of the non-current provisions of £72 million will unwind over several years, as termination payments are made over extended periods in some countries, it is estimated that one-third will unwind in 2013 and over 80 per cent within five years.

Employee related benefits mainly relate to long-term employee benefits other than post-retirement benefits. As the principal components of these provisions are long service awards and 'jubilee' payments due after a certain service period, they will unwind over several years. It is estimated that approximately 50 per cent of the non-current provisions of £28 million will unwind within five years.

A provision of £274 million has been made for a potential claim under a 1998 settlement agreement entered into by a Group subsidiary in respect of the clean up of sediment in the lower Fox River. This is explained in more detail in note 30 (see page 182).

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 £1 million for restructuring of existing businesses, £1 million for employee benefits and £17 million for other provisions.

23 Trade and other payables

	2011 £m	2010 £m
Trade payables	668	712
Duty, excise and other taxes	3,085	3,306
Accrued charges and deferred income	1,168	1,088
Social security and other taxation	8	15
Sundry payables	429	407
	5,358	5,528
Current	5,174	5,335
Non-current	184	193
	5,358	5,528

Accrued charges and deferred income include £8 million (2010: £30 million) in respect of interest payable. Amounts payable to related parties including associated undertakings are shown in note 29.

There is no material difference between the above amounts for trade and other payables and their fair value due to the short-term duration of the majority of trade and other payables.

Trade and other payables are predominantly denominated in the functional currencies of subsidiary undertakings with less than 5 per cent in other currencies.

24 Financial instruments and risk management

Management of financial risks

One of the principal responsibilities of Treasury is to manage the financial risks arising from the Group's underlying operations. Specifically, Treasury manages, within an overall policy framework set by the Group's Main Board and Corporate Finance Committee (CFC), the Group's exposure to funding and liquidity, interest rate, foreign exchange and counterparty risks. The Group's treasury position is monitored by the CFC which meets regularly throughout the year and is chaired by the Group Finance Director. The approach is one of risk reduction within an overall framework of delivering total shareholder return.

The Group defines capital as net debt (see note 21) and equity (see note 20). The only externally imposed capital requirement for the Group is interest cover as described under Interest rate risk below. The Group assesses its financial capacity by reference to cash flow, net debt and interest cover. Group policies include a set of financing principles and key performance indicators including the monitoring of credit ratings, interest cover and liquidity. These provide a framework within which the Group's capital base is managed and, in particular, the policies on dividends (as a percentage of long-term sustainable earnings) and share buy-back are decided. The key objective of the financing principles is to appropriately balance the interests of equity and debt holders in driving an efficient financing mix for the Group.

The Group manages its financial risks in line with the classification of its financial assets and liabilities in the Group's balance sheet and related notes.

The Group's management of specific risks is dealt with as follows:

Liquidity risk

It is the policy of the Group to maximise financial flexibility and minimise refinancing risk by issuing debt with a range of maturities, generally matching the projected cash flows of the Group and obtaining this financing from a wide range of providers. The Group has a target average centrally managed debt maturity of at least 5 years with no more than 20 per cent of centrally managed debt maturing in a single rolling year. As at 31 December 2011, the average centrally managed debt maturity was 7.0 years (2010: 7.4 years) and the highest proportion of centrally managed debt maturing in a single rolling year was 18.3 per cent (2010: 12.5 per cent). In June 2011, the Group established an US\$2 billion commercial paper programme. It is Group policy that short-term sources of funds (including drawings under both the US\$ programme and the existing Group £1 billion euro commercial paper (ECP) programme) are backed by undrawn committed lines of credit and cash. At 31 December 2011, £85 million of commercial paper was outstanding (2010: undrawn).

In November 2011, the Group issued a new €600 million bond with a maturity of November 2021.

In September 2011, the Group repaid a Mexican peso 1,444 million borrowing which was due in September 2011 with a new Mexican peso 1,444 million borrowing due 2014.

In August 2011, the Group extended the maturity date of a US\$200 million facility from 2011 to 2016, and simultaneously increased the size of the facility to US\$240 million. This facility is drawable in Chilean peso and was drawn to the value of US\$225 million at 31 December 2011. The undrawn element of US\$15 million is available for drawing until February 2013.

Notes on the accounts continued

24 Financial instruments and risk management continued

In June 2011, the Group repaid a €530 million bond with the repayment financed from Group cash balances

During the year, the Group's subsidiary in Brazil received proceeds of £401 million (2010: £410 million) from short-term borrowings in respect of advance payments on leaf export contracts and repaid £519 million (2010: £297 million)

In December 2010, the Group negotiated a new central banking facility of £2 billion with a final maturity date of December 2015. This facility is provided by 22 banks. The existing central banking facility of £1.75 billion, with a final maturity date of March 2012 was cancelled at the same time. The facility was undrawn at both 31 December 2011 and 2010.

On 25 June 2010, the terms of €470 million of the €1 billion bond maturing in 2011 were modified by extending the maturity to 2020; at the same time, the Group issued an additional €130 million bond with a maturity of 2020. In addition, €413 million of the Group's €750 million bond maturing in 2012 was purchased and cancelled. At the same time, the Group issued a new £275 million bond with a maturity of 2040.

In May 2010, the Group repaid a €525 million bond. The repayment was financed from debt issued in November 2009.

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 2011 the ratings from Moody's and S&P were Baa1 (stable outlook) / BBB+ (positive outlook) (2010: Baa1/BBB+) and these ratings were maintained throughout the year. The S&P outlook switched from stable to positive on 30 November 2011. The strength of the ratings has underpinned the debt issuance during 2011 and 2010 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 and sterling markets in 2011 and 2010.

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 2011, cash and cash equivalents include £558 million invested in money market funds (2010: £642 million).

Subsidiary companies are funded by share capital and retained earnings, loans from the central finance companies on commercial terms, or through local borrowings by the subsidiaries in appropriate currencies. All contractual borrowing covenants have been met and none of them is expected to inhibit the Group's operations or funding plans.

Currency risk

The Group is subject to exposure on the translation of the net assets of foreign currency subsidiaries and associates into its reporting currency, sterling. The Group's primary balance sheet translation exposures are to the US dollar, Canadian dollar, euro, Danish krone, Turkish lira, South African rand, Russian rouble, Brazilian real, Australian dollar and Japanese yen. 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 2011, the currency profile of the Group's gross debt, after taking into account derivative contracts, was 14 per cent (2010: 13 per cent) US dollar, 43 per cent (2010: 47 per cent) euro, 3 per cent (2010: 3 per cent) Canadian dollar, 12 per cent (2010: 11 per cent) sterling, 11 per cent (2010: 10 per cent) Australian dollar and 17 per cent (2010: 16 per cent) other currencies.

The Group faces currency exposures arising from the translation of profits earned in foreign currency subsidiaries and associates and joint ventures, these exposures are not normally hedged. Exposures also arise from:

- (i) foreign currency denominated trading transactions undertaken by subsidiaries. These exposures comprise committed and highly probable forecast sales and purchases, which are offset wherever possible. The remaining exposures are hedged within the Treasury policies and procedures with forward foreign exchange contracts and options, which are designated as hedges of the foreign exchange risk of the identified future transactions, and
- (ii) forecast dividend flows from subsidiaries to the centre. To ensure cash flow certainty, the Group hedges such flows using forward foreign exchange contracts designated as net investment hedges of the foreign exchange risk arising from the investments in these subsidiaries.

IFRS 7 requires a sensitivity analysis that shows the impact on the income statement and on items recognised directly in other comprehensive income of hypothetical changes of exchange rates in respect of non-functional currency financial assets and liabilities held across the Group. All other variables are held constant although, in practice, market rates rarely change in isolation. Financial assets and liabilities held in the functional currency of the Group's subsidiaries, as well as non-financial assets and liabilities and translation risk, are not included in the analysis. The Group considers a 10 per cent strengthening or weakening of the functional currency against the non-functional currency of its subsidiaries as a reasonably possible change. The impact is calculated with reference to the financial asset or liability held as at the year end, unless this is unrepresentative of the position during the year.

24 Financial instruments and risk management continued

A 10 per cent strengthening of functional currencies against non-functional currencies would result in pre-tax profit being £16 million higher (2010: £36 million higher) and items recognised directly in other comprehensive income being £227 million higher (2010: £273 million higher). A 10 per cent weakening of functional currencies against non-functional currencies would result in pre-tax profit being £23 million lower (2010: £44 million lower) and items recognised directly in other comprehensive income being £277 million lower (2010: £333 million lower).

The exchange sensitivities on items recognised directly in other comprehensive income relate to hedging of certain net asset currency positions in the Group as well as on cash flow hedges in respect of future transactions, but does not include sensitivities in respect of exchange on non-financial assets or liabilities.

Interest rate risk

The objectives of the Group's interest rate risk management policy are to lessen the impact of adverse interest rate movements on the earnings, cash flow and economic value of the Group and to safeguard against any possible breach of its financial covenants. Additional objectives are to minimise the cost of hedging and the associated counterparty risk.

The Group targets an interest cover ratio, as calculated under its key central banking facilities, of greater than 5 and for 2011 it is 12.5 times (2010: 11.2 times). The only externally imposed capital requirement the Group has 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 per cent 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 2011, the relevant ratios of floating to fixed rate borrowings were 38.62 (2010: 33.67) on a gross basis and 17.83 (2010: 9.91) 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 £18 million lower (2010: £12 million lower). A 100 basis point decrease in interest rates, or less where applicable, would result in pre-tax profit being £21 million higher (2010: £8 million higher). The effect of these interest rate changes on items recognised directly in other comprehensive income is not material in either year.

Credit risk

The Group has no significant concentrations of customer credit risk. Subsidiaries have policies in place requiring appropriate credit checks on potential customers before sales commence. The process for monitoring and managing credit risk once sales to customers have been made varies depending on local practice in the countries concerned.

Certain territories have bank guarantees, other guarantees and credit insurance provided in the Group's favour in respect of Group trade receivables, the issuance and terms of which are dependent on local practices in the countries concerned.

All derivatives are subject to ISDA agreements or equivalent documentation.

Cash deposits and other financial instruments give rise to credit risk on the amounts due from the related counterparties. Generally the Group targets a long-term counterparty credit rating of at least A/A2. However the Group recognises that due to the need to operate over a large geographic footprint, sovereign risk can be the determining factor on the suitability of a counterparty. From time to time the Group may invest in short-dated corporate commercial paper and for this, the Group identifies specific counterparties with a minimum short-term rating of A1/P1.

Counterparty credit risk is managed on a global basis by limiting the aggregate amount and duration of exposure to any one counterparty, taking into account its credit rating. The credit ratings of all counterparties are reviewed regularly.

Notes on the accounts continued

24 Financial instruments and risk management continued

The Group ensures that it has sufficient counterparty credit capacity of requisite quality to undertake all anticipated transactions throughout its geographic footprint, while at the same time ensuring that there is no geographic concentration in the location of counterparties.

The maximum exposure to the credit risk of financial assets at the balance sheet date is reflected by the carrying values included in the Group's balance sheet. In addition, the Group has issued guarantees to third parties, part of which has been recognised on the balance sheet in accordance with IAS 39. The unrecognised portion of these guarantees amounts to £28 million (2010: £64 million).

Price risk

The Group is exposed to equity price risk on equity investments held by the Group, which are included in available-for-sale investments on the consolidated balance sheet, but the quantum of such is not material.

Hedge accounting

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

Fair value estimation

The fair values of financial assets and liabilities with maturities of less than one year, other than derivatives, are assumed to approximate their book values. For other financial instruments which are measured at fair value in the balance sheet, the basis for fair values is described below.

Fair value hierarchy

The following table presents the Group's financial assets and liabilities that are measured at fair value in accordance with the IFRS 7 classification hierarchy:

	Level 1 £m	Level 2 £m	Level 3 £m	2011 Total £m
Assets at fair value				
Available-for-sale investments (note 15)	17	42	38	97
Derivatives relating to				
– interest rate swaps (note 16)		186		186
– cross-currency swaps (note 16)		6		6
– forward foreign currency contracts (note 16)		137		137
– others (note 16)		9		9
Assets at fair value	17	380	38	435
Liabilities at fair value				
Derivatives relating to				
– interest rate swaps (note 16)		22		22
– cross-currency swaps (note 16)		46		46
– forward foreign currency contracts (note 16)		182		182
– others (note 16)		14		14
Liabilities at fair value		264		264

24 Financial instruments and risk management continued

				2010
	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Assets at fair value				
Available-for-sale investments (note 15)	6	55	26	87
Derivatives relating to				
– interest rate swaps (note 16)		139		139
– cross-currency swaps (note 16)		16		16
– forward foreign currency contracts (note 16)		109		109
– others (note 16)	4	5		9
Assets at fair value	10	324	26	360
Liabilities at fair value				
Derivatives relating to				
– interest rate swaps (note 16)		8		8
– cross-currency swaps (note 16)		51		51
– forward foreign currency contracts (note 16)		248		248
– others (note 16)		12		12
Liabilities at fair value		319		319

Level 1 financial instruments are traded in an active market and fair value is based on quoted prices at the year end. This category includes listed equity shares of £2 million (2010: £9 million).

Level 2 financial instruments are not traded in an active market, but the fair values are based on quoted market prices, broker/ dealer quotations, or alternative pricing sources with reasonable levels of price transparency. The Group's level 2 financial instruments include certain money market securities and most OTC derivatives.

The fair values of level 3 financial instruments have been determined using a valuation technique where at least one input (which could have a significant effect on the instrument's valuation) is not based on observable market data. The Group's level 3 financial instruments primarily consist of an equity investment in an unquoted entity which is valued using the discounted cash flows of estimated future dividends. The valuation assumes the following:

- future dividends grow by 1.7 per cent (2010: 2 per cent) and a 100 basis points decrease in the growth rate would result in the valuation being £6 million lower (2010: £2 million lower), and
- discount rate of 7 per cent (2010: 8 per cent) and a 100 basis points decrease in the discount rate would result in the valuation being £9 million higher (2010: £4 million higher).

The following table presents the changes in level 3 financial instruments:

	2011	2010
	Available-for-sale investments £m	Available-for-sale investments £m
1 January	26	24
Gains included in other comprehensive income	13	3
Differences on exchange	(1)	(1)
31 December	38	26

Notes on the accounts continued

25 Cash flow

Cash generated from operations

	2011 £m	2010 £m
Profit from operations	4,721	4,318
Adjustments for		
– amortisation and impairment of trademarks	58	106
– amortisation and impairment of intangible assets	365	322
– gains on disposal of businesses		(5)
– depreciation and impairment of property, plant and equipment	394	469
– increase in inventories	(47)	(280)
– increase in trade and other receivables	(87)	(127)
– increase in trade and other payables	46	497
– decrease in net retirement benefit liabilities	(208)	(153)
– increase in provisions for liabilities and charges	232	17
– other non-cash items	63	43
Cash generated from operations	5,537	5,207

Profit from operations includes charges in respect of Group restructuring and integration costs referred to in note 3(e). These are also reflected in the movements in depreciation, amortisation, impairment, inventories, receivables, payables and provisions above and in the proceeds on disposal of property, plant and equipment shown in the Group cash flow statement. The net cash outflow in respect of the Group's restructuring costs was £207 million (2010: £193 million), of which £217 million (2010: £219 million) is included in cash generated from operations above.

Cash flows from investing activities

(a) Purchases and proceeds on disposals of investments

The purchases and disposals of investments (which comprise available-for-sale investments and loans and receivables) comprises a net cash inflow in respect of current investments of £3 million (2010: £1 million outflow).

(b) Proceeds from associates' share buy-backs

In 2011, the proceeds from associates' share buy-backs reflect proceeds of £71 million in respect of the Group's participation in the share buy-back programme conducted by Reynolds American Inc.

(c) Purchase of other subsidiaries and associates

In 2011, the net cash outflow of £295 million on the purchase of Protabaco reflects the settlement of the purchase consideration of £298 million less the acquired net cash and cash equivalents of £3 million, as explained in note 26(a).

(d) Proceeds on disposal of subsidiaries

In 2010, the proceeds on disposal of subsidiaries reflects the consideration received, less cash and cash equivalents disposed of, from the sale of the Group's Belgium distribution business, Lyfra NV, as explained in note 26(b).

Cash flows from financing activities

(a) Cash flows from borrowings

During the year, the Group established an US\$2 billion commercial paper programme. It is Group policy that short-term sources of funds (including drawings under both the US\$ programme and the existing Group £1 billion euro commercial paper (ECP) programme) are backed by undrawn committed lines of credit and cash. At 31 December 2011, £85 million of commercial paper was outstanding (2010: undrawn).

In November 2011, the Group issued a new €600 million bond with a maturity of November 2021.

In September 2011, the Group repaid a Mexican Peso 1,444 million borrowing which was due in September 2011 with a new Mexican peso 1,444 million borrowing due 2014.

In June 2011, the Group repaid a €530 million bond. The repayment was financed from Group cash balances.

During the year the Group's subsidiary in Brazil received proceeds of £401 million (2010: £410 million) from short-term borrowings in respect of advance payments on leaf export contracts and repaid £519 million (2010: £297 million).

In December 2010, the Group negotiated a new central banking facility of £2 billion with a final maturity date of December 2015. This facility is provided by 22 banks. The existing central banking facility of £1.75 billion, with a final maturity date of March 2012, was cancelled at the same time. The facility was undrawn at both 31 December 2011 and 2010.

25 Cash flow continued

On 25 June 2010, the terms of €470 million of the €1 billion bond maturing in 2011 were modified by extending the maturity to 2020; at the same time, the Group issued an additional €130 million bond with a maturity of 2020. In addition, €413 million of the Group's €750 million bond maturing in 2012 was purchased and cancelled. At the same time, the Group issued a new £275 million bond with a maturity of 2040.

In May 2010, the Group repaid a €525 million bond. The repayment was financed from debt issued in November 2009.

(b) Movements relating to derivative financial instruments

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

(c) Purchase of non-controlling interests

In 2011, the cash outflow of £10 million arises from the acquisition of non-controlling interests in Chile. The cash outflow of £12 million in 2010 arises from the acquisition of non-controlling interests in Bentoel of shareholders who did not wish to participate in the merger of Bentoel and BAT Indonesia as well as non-controlling interests in subsidiaries in the EEMEA region.

Notes on the accounts continued

26 Business combinations and disposals

(a) Productora Tabacalera de Colombia, S.A.S (Protabaco)

On 11 October 2011, the Group acquired from Flentex Holdings Limited and Tnoumvr Enterprises Limited, both private investor shareholders, a 100 per cent stake in Productora Tabacalera de Colombia, S.A.S (Protabaco), the second largest cigarette company in Colombia, for US\$461 million (£298 million). The purchase price is subject to the final agreement of adjustments for working capital and net debt with the vendors. The completion follows earlier approval by Colombia's competition authority, the Superintendence of Industry and Commerce, on 2 August 2011.

The goodwill of £134 million on the acquisition of the cigarette business of Protabaco, stated at the exchange rates ruling at the date of the transaction, arises as follows.

Provisional values

	Book value £m	Fair value adjustments £m	Fair value £m
Intangible assets		121	121
Property, plant and equipment	37	17	54
Deferred tax asset	1	(1)	
Inventories	42	(4)	38
Trade and other receivables	19		19
Cash and cash equivalents	3		3
Retirement benefit liabilities	(1)		(1)
Deferred tax liabilities		(42)	(42)
Provisions	(5)	(9)	(14)
Trade and other payables	(11)	(3)	(14)
Net assets acquired	85	79	164
Goodwill			134
Total consideration (note 25(c))			298

Acquisition costs of £3 million have been expensed as part of other operating expenses within restructuring and integration costs (note 3(e)).

The goodwill of £134 million on the acquisition of the business represents a strategic premium to strengthen the Group's position in Latin America's fourth largest market by building on the Group's existing business, and anticipated synergies that will arise from combining the businesses in Colombia, post-acquisition.

In the period from 11 October 2011 to 31 December 2011 the acquired business contributed revenue of £9 million and a loss from operations of £13 million after charging £2 million for amortisation of acquired intangibles and £10 million in respect of restructuring and integration costs.

If the acquisition had occurred on 1 January 2011, before accounting for anticipated synergies and restructuring benefits, it is currently estimated that Group revenue would have been £15,452 million and Group profit from operations would have been £4,714 million for the 12 months to 31 December 2011. These amounts have been estimated based on Protabaco's results for the period prior to acquisition, adjusted to reflect changes arising from differences in accounting policies and the anticipated effect of fair value adjustments. The amounts reported for profit from operations are after charging £9 million for the amortisation of acquired intangibles for the period to 11 October 2011.

(b) Lyfra NV

On 7 April 2010, the Group announced that it had agreed to sell its Belgium distribution business, Lyfra NV, to Landewyck Group S.a r l. The transaction was completed on 25 June 2010 for a consideration of €16 million and resulted in a gain of £5 million. Lyfra contributed £215 million to revenue and £1 million to profit from operations to 25 June 2010 in the Western Europe region.

(c) Items classified as held-for-sale

At 31 December 2011, held-for-sale assets comprise mainly land and buildings in Turkey and Denmark which are being actively marketed for sale. At 31 December 2010, the held-for-sale assets included amounts in relation to land and buildings in Canada which were sold in early 2011.

(d) Gauloises licence agreement termination

With effect from the end of the first quarter in 2010, the Gauloises licence agreement applicable in Germany, was terminated. The agreement resulted in a revenue contribution of £37 million and a profit contribution of £5 million to the 2010 results in the Western Europe region.

(e) Phone card distribution business in Brazil

During 2010, the Group made the decision to withdraw from distributing phone cards in Brazil. The phone card distribution business contributed £134 million to revenue and £3 million to profit from operations in the Americas region in 2010.

26 Business combinations and disposals continued

(f) Termination of distributor arrangement

With effect from 1 July 2011, the arrangement by which the Group acted as a distributor for a third party in Norway was terminated. This arrangement contributed £57 million to revenue and less than £1 million to profit from operations in the Western Europe region in 2010. For the six months ended 30 June 2011, it contributed £25 million to revenue and less than £1 million to profit from operations.

Notes on the accounts continued

27 Share-based payments

The Group operates a number of share-based payment arrangements of which the two principal ones are

Long-Term Incentive Plan (LTIP)

Nil-cost options exercisable after three years from date of grant with a contractual life of ten years. Payout is subject to performance conditions based on earnings per share relative to inflation (50 per cent of grant) and total shareholder return, combining the share price and dividend performance of the Company by reference to two comparator groups (50 per cent of grant). Participants are not entitled to dividends prior to the exercise of the options. A cash equivalent dividend accrues through the vesting period and is paid on vesting. Both equity and cash-settled LTIPs are granted in March each year. In 2011 the Management Board LTIP award was made in May.

Deferred Share Bonus Scheme (DSBS)

Free ordinary shares released three years from date of grant and may be subject to forfeit if participant leaves employment before the end of the three year holding period. Participants receive a separate payment equivalent to a proportion of the dividend payment during the holding period. Both equity and cash-settled grants are granted in March each year.

The Group also has a number of other arrangements which are not material for the Group and these are as follows

Share Option Scheme (ESOS)

Options exercisable three years from date of grant with a contractual life of ten years, subject to earnings per share performance condition relative to inflation. Participants are not entitled to receive dividends in the period prior to the exercise of the options.

The granting of options under this scheme ceased with the last grant made in March 2004 and final outstanding awards must be exercised by March 2014. The awards were both equity and cash-settled.

Sharesave Scheme (SAYE)

Options granted in March each year from 2011 onwards (previously November until 2009 and no options were granted during 2010) by invitation at a 20 per cent 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 plc. 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

	2011		2010	
	Equity-settled £m	Cash-settled £m	Equity-settled £m	Cash-settled £m
LTIP (note (a))	28	9	30	9
DSBS (note (b))	43	12	33	10
ESOS (note (c))				1
SAYE (note (c))	1		1	
SRS (note (c))	4		3	
Total recognised in the income statement (note 3(a))	76	21	67	20

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 2011 and 2010:

	2011		2010	
	Vested £m	Unvested £m	Vested £m	Unvested £m
LTIP	3.7	11.4	2.1	11.1
DSBS		17.1	0.6	12.4
ESOS	0.6		1.0	
Total liability	4.3	28.5	3.7	23.5

(a) Long-Term Incentive Plan

Details of the movements for the equity and cash-settled LTIP scheme during the years ended 31 December 2011 and 31 December 2010, were as follows:

	2011		2010	
	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	7,292	960	7,560	1,283
Granted during the period	2,256	252	2,383	272
Exercised during the period	(2,335)	(299)	(2,202)	(538)
Forfeited during the period	(624)	(84)	(449)	(57)
Outstanding at end of year	6,589	829	7,292	960
Exercisable at end of year	374	135	392	104

The weighted average British American Tobacco p.l.c. share price at the date of exercise for share options exercised during the period was £25.52 (2010: £22.44) for equity-settled and £25.86 (2010: £22.63) for cash-settled options.

The outstanding shares for the year ended 31 December 2011 had a weighted average contractual life of 8.0 years (2010: 8.2 years) for the equity-settled scheme, and 7.5 years (2010: 7.8 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 2011 and 31 December 2010, were as follows

	2011		2010	
	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	5,482	911	5,696	910
Granted during the period	2,474	388	1,961	320
Exercised during the period	(1,780)	(295)	(2,138)	(291)
Forfeited during the period	(67)	(50)	(37)	(28)
Outstanding at end of year	6,109	954	5,482	911
Exercisable at end of year	3		3	2

The weighted average British American Tobacco p.l.c. share price at the date of exercise for share options exercised during the period was £25.08 (2010 £22.40) for equity-settled and £25.65 (2010 £22.52) for cash-settled options

The outstanding shares for the year ended 31 December 2011 had a weighted average contractual life of 1.3 years (2010 1.4 years) for the equity-settled scheme, and 1.2 years (2010 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 were 385,451 (2010 629,598) and cash-settled options were 24,870 (2010 60,092)

SAYE

The number of outstanding options at the end of the year for the three year scheme were 317,484 (2010 297,415) and for the five year scheme were 564,484 (2010 584,566)

SRS and ISRS

The number of outstanding shares at the end of the year for the Share Reward Scheme were 591,204 (2010 607,228) and for the International Share Reward Scheme were 76,213 (2010 85,762)

Valuation assumptions

Assumptions used in the Black-Scholes models to determine the fair value of share options at grant date were as follows.

	2011		2010	
	LTIP	DSBS	LTIP	DSBS
Expected volatility (%)	25	25	25	25
Average expected term to exercise (years)	3.5	3.0	3.5	3.0
Risk-free rate (%) *	2.0/1.6	1.8	2.1	1.8
Expected dividend yield (%) *	4.8/4.2	4.8	4.4	4.4
Share price at date of grant (£) *	23.77/27.15	23.77	22.58	22.58
Fair value at grant date (£) *	15.60/18.60	20.58	15.62	19.78

* Where two figures have been quoted for the Long-term incentive plan, the first number represents the March award and the second number the May 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

	2011	2010
	%	%
Average share price volatility FTSE 100 comparator group *	40/39	38
Average share price volatility FMCG comparator group *	26/26	25
Average correlation FTSE 100 comparator group *	39/21	37
Average correlation FMCG comparator group *	35/35	33

* Where two figures have been quoted for the Long-term incentive plan, the first number represents the March award and the second number the May award

27 Share-based payments continued

Fair values determined from the Black-Scholes and Monte Carlo models use assumptions revised at the end of each reporting period for cash-settled share-based payment arrangements

The expected British American Tobacco plc share price volatility was determined taking account of the return index, (the share price index plus the dividend reinvested) over a five year period. The respective FMCG and FTSE 100 share price volatility and correlations were also determined over the same periods. The average expected term to exercise used in the models has been adjusted, based on management's best estimate, for the effects of non-transferability, exercise restrictions and behavioural conditions, forfeiture and historical experience.

The risk-free rate has been determined from market yield curves for government gilts with outstanding terms equal to the average expected term to exercise for each relevant grant. The expected dividend yield was determined by calculating the yield from the last two declared dividends divided by the grant share price.

In addition to these valuation assumptions, LTIP awards contain earnings per share performance conditions. As these are non-market performance conditions they are not included in the determination of fair value of share options at the grant date, however they are used to estimate the number of awards expected to vest. This payout calculation is based on expectations published in analysts' forecasts.

28 Group employees

The average number of persons employed by the Group and its associates during the year, including Directors, was 87,813 (2010 92,285)

	2011 Number	Restated 2010 Number
Asia-Pacific	15,351	15,848
Americas	16,661	16,423
Western Europe	12,138	15,122
EEMEA	12,115	13,038
Subsidiary undertakings	56,265	60,431
Associates	31,548	31,854
	87,813	92,285

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.

The number of Group employees for 2010 has been restated as a result of the reduction in the number of regions, as explained in note 2.

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 £87 million (2010: £77 million). The Group's share of dividends from associates, included in other net income in the table below, was £486 million (2010: £466 million). Legal fees recovered from Reynolds American Inc. included in other net income amounted to £nil (2010: £1 million).

	2011 £m	2010 £m
Transactions		
– revenue	28	38
– purchases	(342)	(442)
– other net income	487	460
Amounts receivable at 31 December	97	99
Amounts payable at 31 December	(40)	(21)

On 26 May 2010, a wholly-owned subsidiary of the Group, BATUS Japan Inc., entered into an American blend Cigarette Manufacturing Agreement (referred to as the 2010 Agreement) with a wholly-owned subsidiary of Reynolds American, R.J. Reynolds Tobacco Company (referred to as RJRTC), with an effective date of 1 January 2010. Under this Agreement, RJRTC has been appointed as BATUS Japan's exclusive manufacturer of all BATUS Japan's requirements for certain American-blend cigarettes intended to be distributed and sold in Japan for the five year period expiring on 31 December 2014, subject to the early termination and extension provisions set out in the agreement. The 2010 Agreement is based on arm's length terms and conditions.

On the same date, RJRTC and BATUS Japan entered into a letter agreement terminating the existing Contract Manufacturing Agreement dated 30 July 2004 (referred to as the 2004 Agreement), as amended between the parties, with effect from midnight on 31 December 2009. The 2004 Agreement was scheduled to expire on 31 December 2014, subject to early termination and extension provisions. Under the terms of the letter agreement, certain sections and sub-sections of the 2004 Agreement will survive the termination, and, in consideration for RJRTC agreeing to terminate the agreement and in settlement of all disputes at issue between the parties, BATUS Japan agreed to pay RJRTC US\$21 million. The payment has been presented as an adjusting item and is included within the Group's restructuring and integration costs in note 3(e). The Group's share of the income net of tax included within the post-tax results of Reynolds American is also presented as an adjusting item and is credited against other (see note 5).

In 2011, the Group acquired non-controlling interests of shareholders in Chile for £10 million. This transaction is shown as a £10 million reduction to reserves in note 20. In 2010, the Group acquired non-controlling interests of shareholders in Indonesia and eastern Europe for £3 million and £9 million respectively. These transactions are shown as a £12 million reduction to reserves in note 20.

As explained in note 26(b), the Group sold its Belgium distribution business, Lyfra NV, to Landewyck Group S.a.r.l. in 2010 for a consideration of €16 million. The Group's German subsidiary has an available-for-sale investment in Landewyck Group S.a.r.l.

The key management personnel of British American Tobacco consist of the members of the Board of Directors of British American Tobacco plc. 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.

	2011 £m	2010 £m
The total compensation for key management personnel, including Directors, was		
– salaries and other short-term employee benefits	21	22
– post-employment benefits	3	3
– share-based payments	8	12
	32	37

There were no other long-term benefits applicable in respect of key personnel other than those disclosed in the remuneration report in the Annual Report.

30 Contingent liabilities and financial commitments

The Group is subject to contingencies pursuant to requirements that it complies with relevant laws, regulations and standards. Failure to comply could result in restrictions in operations, damages, fines, increased tax, increased cost of compliance, interest charges, reputational damage or other sanctions. These matters are inherently difficult to quantify.

In cases where the Group has an obligation as a result of a past event existing at the balance sheet date, it is probable that an outflow of economic resources will be required to settle the obligation and the amount of the obligation can be reliably estimated, a provision will be recognised based on best estimates and management judgment.

There are, however, contingent liabilities in respect of litigation, taxes in some countries and guarantees for which no provisions have been made.

The Group has exposures in respect of the payment or recovery of a number of taxes. The Group is and has been subject to a number of tax audits covering, amongst others, excise tax, value added taxes, sales taxes, corporate taxes, withholding taxes and payroll taxes.

The estimated costs of known tax obligations have been provided in these accounts in accordance with the Group's accounting policies. In some countries, tax law requires that full or part payment of disputed tax assessments be made pending resolution of the dispute. To the extent that such payments exceed the estimated obligation, they would not be recognised as an expense. In some cases disputes are proceeding to litigation.

While the amounts that may be payable or receivable could be material to the results or cash flows of the Group in the period in which they are recognised, the Board does not expect these amounts to have a material effect on the Group's financial condition.

Product liability litigation

Group companies, notably Brown & Williamson Holdings, Inc (formerly Brown & Williamson Tobacco Corporation) (B&W) as well as other leading cigarette manufacturers, are defendants, principally in the United States, in a number of product liability cases. In a number of these cases, the amounts of compensatory and punitive damages sought are significant.

Indemnity

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

- B&W discontinued the active conduct of any tobacco business in the United States,
- B&W contributed to RJRT all of its assets other than the capital stock of certain subsidiaries engaged in non-US businesses and other limited categories of assets,
- RJRT assumed all liabilities of B&W (except liabilities to the extent relating to businesses and assets not contributed by B&W to RJRT and other limited categories of liabilities) and contributed subsidiaries or otherwise to the extent related to B&W's tobacco business as conducted in the United States on or prior to 30 July 2004, and
- RJRT agreed to indemnify B&W and each of its associates (other than Reynolds American Inc. and its subsidiaries) against, among other matters, all losses, liabilities, damages, expenses, judgments, attorneys' fees, etc., to the extent relating to or arising from such assumed liabilities or the assets contributed by B&W to RJRT (the RJRT Indemnification).

The scope of the RJRT Indemnification includes all expenses and contingent liabilities in connection with litigation to the extent relating to or arising from B&W's US tobacco business as conducted on or prior to 30 July 2004, including smoking and health tobacco litigation, whether the litigation is commenced before or after 30 July 2004 (the Tobacco Litigation).

Pursuant to the terms of the RJRT Indemnification, RJRT is liable for any possible judgments, the posting of appeal bonds or security, and all other expenses of and responsibility for managing the defence of the Tobacco Litigation. RJRT has assumed control of the defence of the Tobacco Litigation involving B&W, to which RJRT is also a party in most (but not all) of the same cases. Accordingly, RJRT uses or plans to use the same law firm or firms to represent both B&W and RJRT in any single or similar case (except in certain limited circumstances) as RJRT's interests are typically aligned with B&W's interests, as RJRT has substantial experience in managing recognised external legal counsel in defending the Tobacco Litigation and external counsel have independent professional responsibilities to represent the interests of B&W. In addition, in accordance with the terms of the RJRT Indemnification, associates of B&W have retained control of the defence in certain Tobacco Litigation cases with respect to which such associates are entitled to indemnification.

Included in the US litigation section below are all significant cases where B&W and/or a UK company is named as a defendant and all cases where RJRT is named as a defendant as a successor to B&W (the RJRT Successor Cases). The RJRT Successor Cases are covered by the RJRT Indemnification. Of the RJRT Successor Cases, the section below includes details of all cases where there has been an adverse judgment and also notes favourable judgments.

US litigation

The total number of US product liability cases pending at 31 December 2011 naming B&W was approximately 8,688 (2010 approximately 9,458). Of these, 5,588 cases are RJRT Successor Cases. For all of these cases, British American Tobacco Group companies have the protection of the RJRT Indemnification. British American Tobacco (Investments) Limited (Investments) has been served as a co-defendant in three of those cases (2010 five). No other UK based Group company has been served as

Notes on the accounts continued

30 Contingent liabilities and financial commitments continued

a co-defendant in any US product liability case pending as at 31 December 2011. In 2011, there was one US product liability case tried to verdict against B&W and Investments (City of St. Louis – see below). There is one case (Daric Smith – see below) against B&W and Investments scheduled for trial on 16 July 2012. Since many of these pending cases seek unspecified damages, it is not possible to quantify the total amounts being claimed, but the aggregate amounts involved in such litigation are significant, possibly totalling billions of US dollars. The cases fall into 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. Although B&W continues to be a defendant in one healthcare cost recovery case involving a Native American tribe (see below), the vast majority of such cases have been dismissed on legal grounds.

Further, on 23 November 1998, the major US cigarette manufacturers (including B&W and RJRT) and the attorneys general of 46 US states and five US territories executed the Master Settlement Agreement (MSA), which settled medical reimbursement lawsuits that had been brought by these states and territories. Under the terms of the MSA, the settling cigarette manufacturers agreed, among other things, to pay approximately US\$246 billion to the settling states and territories (and to four states that reached separate settlements of their medical reimbursement actions) over 25 years, and agreed to various restrictions on US tobacco advertising and marketing. The MSA includes a credit for any amounts paid by participating manufacturers in subsequent suits brought by the states' political subdivisions.

At 31 December 2011, one US medical reimbursement suit was pending against B&W (2010 three). This suit has been brought by an Indian tribe in the Indian Tribal Court in South Dakota.

Two additional reimbursement cases pending against Group companies as at 31 December 2010 have recently been dismissed. The Nat'l Committee to Preserve Social Security & Medicare case against B&W and other defendants was dismissed by the district court on 22 December 2010 and judgment was entered in defendants' favour on 23 December 2010. The City of St. Louis case against B&W, Investments and several other defendants was dismissed following a jury verdict in defendants' favour on 29 April 2011. Final judgment was entered in defendants' favour on 10 June 2011 and the plaintiffs waived all rights to appeal this judgment.

(b) Class actions

At 31 December 2011, B&W was named as a defendant in some eight (2010 eight) separate actions attempting to assert claims on behalf of classes of persons allegedly injured or financially impacted through smoking or where classes of tobacco claimants have been

certified. If the classes are or remain certified and the possibility of class-based liability is eventually established, it is likely that individual trials will be necessary to resolve any claims by individual plaintiffs. Class action suits have been filed in a number of states against individual cigarette manufacturers and their parent corporations, alleging that the use of the terms 'lights' and 'ultralights' constitutes unfair and deceptive trade practices.

The Cleary putative class action complaint was filed in state court in Chicago, Illinois on 3 June 1998 against several defendants, including B&W, B A T Industries p l c (Industries) and Investments. Industries was dismissed on jurisdictional grounds by an intermediate appellate court on 17 March 2000. The case was removed to the federal district court on 13 March 2009. After certain discovery and motion practice, the plaintiffs' motion for leave to file a Fourth Amended Complaint was granted on 22 April 2010. The Fourth Amended Complaint alleged that all defendants fraudulently concealed facts regarding the addictive nature of nicotine and that defendant Philip Morris fraudulently marketed Marlboro Lights cigarettes, and sought disgorgement of profits. The defendants' motion to dismiss the Fourth Amended Complaint was granted on 22 June 2010. The plaintiffs filed a notice of appeal in the US Court of Appeals for the Seventh Circuit on 20 August 2010. In an order entered on 25 August 2011, the Seventh Circuit affirmed the federal district court's order dismissing the case. The plaintiffs' petition for rehearing with suggestion for rehearing en banc was denied by the Seventh Circuit on 15 November 2011. The plaintiffs have not sought further review of this decision.

In a medical monitoring class action brought on behalf of Louisiana smokers (Scott) the jury returned a verdict on 28 July 2003 in favour of the defendants on the plaintiffs' claim for medical monitoring and found that cigarettes were not defectively designed. However, the jury also made certain findings against the defendants on claims relating to fraud, conspiracy, marketing to minors and smoking cessation. Notwithstanding these findings, this portion of the trial did not determine liability as to any individual class member or class representative. On 21 May 2004, the jury returned a verdict in the amount of US\$591 million, requiring the defendants to fund a cessation programme to help eligible class members stop smoking. On 29 September 2004, the defendants posted a US\$50 million bond, pursuant to legislation that limits the amount of the bond to US\$50 million collectively for MSA signatories, and noticed their appeal. RJRT posted US\$25 million (the portions for RJRT and B&W) towards the bond. On 7 February 2007, the Louisiana Court of Appeals upheld the class certification and found the defendants responsible for funding smoking cessation for eligible class members. The appellate court also ruled, however, that no class member who began smoking after 1 September 1988 could receive any relief and that only those smokers whose claims accrued on or before 1 September 1988 would be eligible for the smoking cessation programme. In addition, the appellate court rejected the award of prejudgment interest, and struck eight of the 12 components of the smoking cessation programme. The defendants' application to the Louisiana Supreme Court for a writ of certiorari was denied on 7 January 2008. The defendants' petition to the US Supreme Court for a writ of certiorari was denied on 10 June 2008. On 21 July 2008, the trial court entered an amended judgment in the case. The court found that the defendants are jointly and severally liable for funding the cost

30 Contingent liabilities and financial commitments continued

of a court-supervised smoking cessation programme and ordered the defendants to deposit approximately US\$263 million together with interest from 30 June 2004, into a trust for the funding of the programme. On 23 April 2010, the Louisiana Court of Appeals amended but largely affirmed the trial court's amended judgment. Pursuant to the judgment, the defendants are required to deposit US\$242 million with the court, with interest from 21 July 2008 until paid. In September 2010, the defendants' application for writ of certiorari or review by the Supreme Court of Louisiana along with the defendants' motion to stay execution of the judgment was denied. On 24 September 2010, the US Supreme Court granted the defendants' motion to stay the judgment pending the US Supreme Court's disposition of the defendants' petition for a writ of certiorari. The defendants' petition for writ of certiorari in the US Supreme Court was denied on 27 June 2011. In August 2011, RJRT paid US\$139 million (the portion of the judgment allocated to RJRT and B&W) into the trust. On 31 October 2011, the plaintiffs requested that defendants pay attorneys' fees and litigation costs to plaintiffs' counsel. The defendants filed their opposition to the plaintiffs' request for attorney's fees on 6 January 2012. Discovery on this issue is currently continuing.

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. Altna Group, Inc.* On 28 June 2011, the court issued a memorandum removing the case from the trial docket. A status conference is currently scheduled for 4 February 2013.

Brown is a case filed in June 1997 in the Superior Court, San Diego County, California. On 11 April 2001, the court granted in part the plaintiffs' motion for certification of a class composed of residents of California who smoked at least one of the defendants' cigarettes from 10 June 1993 through 23 April 2001, and who were exposed to the defendants' marketing and advertising activities in California. The plaintiffs seek to recover restitution, disgorgement of profits and other equitable relief under the California Business and Professions Code. Certification was granted as to the plaintiffs' claims that the defendants violated the section of the California Business and Professions Code pertaining to unfair competition. The court, however, refused to certify the class under the California Legal Remedies Act and on the plaintiffs' common law claims. On 7 March 2005, the court granted the defendants' motion to decertify the class. On 5 September 2006, the California Court of Appeal affirmed the judge's order decertifying the class. On 1 November 2006, the plaintiffs' petition for review with the California Supreme Court was granted. On 18 May 2009, the California Supreme Court reversed the decision issued by the trial court and affirmed by the California Court of Appeal that decertified the class to the extent that it was based upon the conclusion that all class members were required to demonstrate standing, and remanded the case to the trial court for further proceedings regarding whether the class representatives have,

or can demonstrate, standing. On 10 March 2010, the California Superior Court found that the plaintiffs' 'lights' claims were not pre-empted by the Federal Cigarette Labelling and Advertising Act, held the court's 30 September 2004 ruling on the issue no longer viable and denied the defendants' second motion for summary judgment. The defendants filed a motion on 9 January 2012 requesting that the class be decertified because the class representatives do not meet the requisites of standing, adequacy, or typicality needed to represent the class. Trial is scheduled to begin on 5 October 2012.

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, US cigarette manufacturers, including B&W, among other defendants, seeking to recover US\$1 million in compensatory and punitive damages individually and an unspecified amount for the class in both compensatory and punitive damages. The action was brought on behalf of a class of persons who allegedly have personal injury claims 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. On 26 December 2000, three defendants, Nitral Liquidators, Inc., Desseaux Corporation of North America and Armstrong World Industries, filed bankruptcy petitions in the US Bankruptcy Court for the District of Delaware. Pursuant to the Bankruptcy Code, Parsons is automatically stayed with respect to all defendants.

Young is a case filed in November 1997 in the Circuit Court, Orleans Parish, Louisiana. The plaintiffs brought an Environmental Tobacco Smoke (ETS) class action on behalf of all residents of Louisiana who, though not themselves cigarette smokers, have been exposed to second-hand smoke from cigarettes which were manufactured by the defendants, and who allegedly suffered injury as a result of that exposure. The plaintiffs seek to recover an unspecified amount of compensatory and punitive damages. On 13 October 2004, the trial court stayed this case pending the outcome of appellate review in the Scott class action in Louisiana (discussed above).

Notes on the accounts continued

30 Contingent liabilities and financial commitments continued

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. On 16 July 2003, the plaintiffs filed a motion for rehearing which was denied on 22 September 2003. On 12 May 2004, the Florida Supreme Court agreed to review this case and, on 6 July 2006, it upheld the intermediate appellate court's decision to de-certify the class and vacated the jury's punitive damages verdict. Further, the Florida Supreme Court permitted the judgments entered for two of the three Engle class representatives to stand, but dismissed the judgment entered in favour of the third Engle class representative. Finally, the Florida Supreme Court has permitted putative Engle class members to file individual lawsuits against the Engle defendants within one year of the court's decision (subsequently extended to 11 January 2008). The court's order precludes defendants from litigating certain issues of liability against the putative Engle class members in these individual actions. On 7 August 2006, the defendants filed a motion for rehearing before the Florida Supreme Court, which was granted in part and denied in part, on 21 December 2006. The Florida Supreme Court's 21 December 2006 ruling did not amend any of the earlier decisions' major holdings, which included decertifying the class, vacating the punitive damages judgment, and permitting individual members of the former class to file separate suits. Instead, the ruling addressed the claims on which the Engle jury's phase one verdict will be applicable to the individual lawsuits that were permitted to stand. On 1 October 2007, the United States Supreme Court denied the defendants' request for certiorari review of the Florida Supreme Court's decision.

As at 31 December 2011, B&W has been served in approximately 47 Engle progeny cases in both state and federal courts in Florida. These cases include approximately 103 plaintiffs. RJRT as a successor to B&W is named in approximately 5,572 Engle progeny cases. These 47 B&W cases and 5,572 RJRT have the benefit of the RJRT indemnification.

In the first 'phase three' trial of an individual Engle class member (Lukacs), the jury awarded the plaintiff US\$37.5 million in compensatory damages (B&W's share US\$8.4 million) on 11 June 2002. On 1 April 2003, the jury award was reduced to US\$25.1 million (B&W's share US\$5.6 million) but no final judgment was entered into because the trial court postponed the entry of final judgment until the Engle appeal was fully resolved. The trial court, on 14 August 2008, issued an order entering judgment for the plaintiff that awarded US\$24.8 million to the plaintiff (plus interest), for which the defendants would be jointly and severally liable. On 17 October 2008, the plaintiff withdrew her request for punitive damages. On 12 November 2008, the trial court entered final judgment. On 1 December 2008, the defendants filed a notice of appeal. On 17 March 2010, the Third District Court of Appeal affirmed the ruling of the trial court. The defendants' motion for rehearing and petition for rehearing en banc was denied on 18 May 2010. RJRT expensed and paid the final judgment in the amount of

approximately US\$15.2 million on 18 June 2010. On 21 June 2010, the court entered an order discharging the supersedeas bonds posted by the defendants.

As at 31 December 2011, approximately 22 additional phase three Engle trials naming RJRT as successor to B&W have proceeded to verdict. There have been no additional phase three Engle progeny trials naming B&W individually. Of these 22 trials, approximately 11 resulted in plaintiffs' verdicts. Total damages awarded against RJRT as successor to B&W in final judgments in these cases are approximately US\$21,493,351. This number is comprised of approximately US\$10,593,351 in compensatory damages and approximately US\$10,900,000 in punitive damages. As of 31 December 2011, RJRT had appealed 10 of these adverse judgments and all of these appeals remained pending. As of 31 December 2011, RJRT's time to file a notice of appeal from the eleventh of these final judgments had not expired.

In June 2009, the Florida legislature amended its existing bond cap statute by adding a US\$200 million bond cap that applies to all phase three Engle progeny cases in the aggregate and establishing individual bond caps for individual cases in amounts that vary depending on the number of judgments in effect at a given time. In May 2011, Florida removed the provision in this legislation that would have permitted this bond cap to expire on 31 December 2012. Plaintiffs in several Engle progeny cases have challenged the constitutionality of the bond cap. The Florida appellate courts upheld the constitutionality of the bond cap in each of these cases. 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.

(c) Individual cases

Approximately 3,091 cases were pending against B&W at 31 December 2011 (2010: 3,161), 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. Of these cases, approximately (a) 2,586 are ETS cases brought by flight attendants who were members of a class action (Broin) that was settled on terms that allow compensatory but not punitive damages claims by class members, (b) 411 are cases brought in consolidated proceedings in West Virginia, where the first phase of the trial began on 19 October 2011 but ended in a mistrial on 8 November 2011, (c) 47 are Engle progeny cases that have been filed directly against B&W, and (d) 47 are cases filed by other individuals.

As mentioned above there are a further 5,572 Engle progeny cases which name RJRT as successor to B&W. In addition, there are 16 cases filed by other individuals naming RJRT as successor to B&W. These cases are subject to the RJRT indemnification and are not detailed here.

30 Contingent liabilities and financial commitments continued

Of the individual cases that remain pending as of 31 December 2011, two resulted in verdicts against B&W

In December 2003, a New York jury (Frankson) awarded US\$350,000 in compensatory damages against B&W and two industry organisations. In January 2004, the same jury awarded US\$20 million in punitive damages. On 22 June 2004, the trial judge granted a new trial unless the parties agreed to an increase in compensatory damages to US\$500,000 and a decrease in punitive damages to US\$5 million, of which US\$4 million would be awarded against B&W. The plaintiff agreed to a decrease in punitive damages but B&W has not agreed to an increase in compensatory damages. On 25 January 2005, B&W appealed to an intermediate New York State appellate court. Oral argument was heard on 8 May 2006. The appellate court affirmed the judgment on 5 July 2006, except insofar as it dismissed the plaintiff's design defect claims. The intermediate appellate court denied B&W's motion for leave to reargue, or in the alternative, for leave to appeal to the New York Court of Appeals on 5 October 2006. On 8 December 2006, the trial judge granted the plaintiff's application for entry of judgment in the amounts of US\$5 million in punitive damages and US\$175,000 in compensatory damages. The trial court also granted the plaintiff's motion to vacate that part of the 2004 order granting a new trial unless the parties agreed to an increase in compensatory damages to US\$500,000. RJRT posted a bond in the approximate amount of US\$8.018 million on 3 July 2007. B&W appealed from final judgment on 3 July 2007 to an intermediate New York State appellate court. Oral argument was heard on 28 January 2009. On 29 September 2009, the appellate court issued a decision modifying the final judgment by deleting the award of punitive damages, and remanding the case to the trial court for a new trial on the issue of punitive damages. On 15 January 2010, the appellate court denied the plaintiff's motion for additional time to seek leave to appeal to the New York Court of Appeals, but granted the plaintiff more time to file a motion for leave to reargue to the appellate court. The plaintiff's motion for leave to reargue was denied by the appellate court on 12 March 2010. As at 31 December 2011, no date has been set for a new trial on the issue of punitive damages.

On 1 February 2005, a Missouri jury (Lincoln Smith) awarded US\$500,000 in compensatory damages against B&W and then, on 2 February 2005, awarded US\$20 million in punitive damages, also against B&W. On 1 June 2005, B&W filed its notice of appeal. Oral argument was heard on 31 August 2006. On 31 July 2007, an intermediate Missouri appellate court affirmed the compensatory damages award but it reversed the punitive damages award, reasoning that the plaintiffs failed to produce sufficient evidence to justify the verdict. The majority of the court would have remanded the case for a second trial, limited to punitive damages, but a dissenting judge transferred the case to the Missouri Supreme Court, as permitted by Missouri law. Oral argument was heard by the Missouri Supreme Court on 13 February 2008. On 31 July 2008, the Missouri Supreme Court transferred the case back to the intermediate appellate court for further proceedings. In a decision entered on 16 December 2008, the intermediate appellate court again upheld the award of compensatory damages and reversed the jury's award of US\$20 million in punitive damages, sending the

case back to the trial court for a new trial on punitive damages. Following a new trial, on 20 August 2009, a Missouri jury returned a verdict awarding 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, asking the court to increase the amount of punitive damages from US\$1.5 million 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. On 30 December 2009, B&W filed a notice of appeal. On 31 December 2009, the plaintiffs filed a notice of appeal. The appeals were consolidated and oral argument was held with respect to both appeals on 28 September 2011. A decision remains pending.

(d) Other claims

The Flintkote Company (Flintkote), a US asbestos production and sales company, was included in the acquisition of Genstar Corporation by Imasco Limited in 1986 and became a Group subsidiary following the restructuring of Imasco Limited (now Imperial Tobacco Canada Limited (Imperial)), the Group's operating company in Canada) in 2000. Soon after this acquisition, and as part of the acquisition plan, Genstar 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 liabilities, Flintkote and Imasco Limited authorised the payment of a dividend of US\$170.2 million in 1986 and a further dividend of US\$355 million in 1987. In 2003, Imperial divested Flintkote and then, in 2004, Flintkote filed for bankruptcy in the United States Bankruptcy court for the District of Delaware. In 2006, Flintkote, representatives of both the present and future asbestos claimants, and individual asbestos claimants were permitted by the bankruptcy court to file a complaint against Imperial and numerous other defendants including S&C, for the recovery of the dividends and other compensation under various legal and equitable theories. S&C and Imperial filed cross complaints against each other. The case remains in the discovery phase, but over the last 18 months the court has resolved multiple issues that will narrow the case. Firstly, following a multi-day bench trial, the court issued a preliminary decision dismissing S&C. Flintkote settled with S&C for a nominal sum before the decision was made final. The settlement is subject to bankruptcy court approval but is expected to become final. Secondly, after a series of bench trials, on 5 October 2011, the court issued 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's rulings largely remove Flintkote's claim to the US\$355 million 1987 dividend. The court also concluded that Flintkote cannot pursue its alter ego claim (such claims must instead be pursued by individual asbestos plaintiffs). These rulings were made final on 6 January 2012. The remaining preliminary issue pending is whether Flintkote is stopped from pursuing certain fraudulent conveyance remedies as a result of contrary statements it made early in the litigation. Discovery is ongoing and is likely to continue throughout 2012. Flintkote intends to press the court to set a trial date in mid-2012 but it appears unlikely that a trial could be held before late 2012 or early 2013.

Notes on the accounts continued

30 Contingent liabilities and financial commitments continued

In Wisconsin, the authorities have identified potentially responsible parties (PRPs) to fund the clean up of river sediments in the lower Fox River. The pollution was caused by discharges of Polychlorinated Biphenyls (PCBs) from paper mills and other facilities operating close to the river. The cost of the clean up work has been estimated to be in excess of US\$900 million. Among the potentially responsible parties is NCR Corporation (NCR) which is liable for the clean up costs in a large portion of the river under the terms of a consent decree and a unilateral administrative order issued by the United States Environmental Protection Agency.

In 1978, a subsidiary of Industries, later known as Appleton Papers Inc (Appleton), purchased what was then NCR's Appleton Papers Division from NCR. In 1978, Industries also incorporated a US entity by the name of BATUS, Inc (BATUS), which in 1980 became the holding company for all of Industries' US subsidiaries, including Appleton. As the holding company, BATUS obtained insurance policies for itself and its subsidiaries that included coverage for certain environmental liabilities. Industries/BATUS spun off the Appleton business in 1990 via a Demerger Agreement with Wiggins Teape Appleton plc, now known as Windward Prospects Ltd (Windward), and Wiggins Teape Appleton (Holdings) plc, now known as Arjo Wiggins US Holdings Ltd (together, the AWA Entities), obtaining what Industries believes were full indemnities from the AWA Entities and Appleton for past and future environmental claims.

Disputes between NCR, Appleton, and Industries as to the indemnities given and received under the original purchase agreement in 1978 have been the subject of litigation that was commenced in 1995, a settlement agreement executed in 1998 (the Settlement Agreement), and an arbitration award in 2005. Under the terms of the Settlement Agreement and the arbitration award, Industries and Appleton generally have an obligation to share the costs of Fox River environmental claims with NCR (60/40), but Industries has never been required to pay any sums in this regard because Appleton and the AWA Entities have paid the non-NCR (60 per cent) share of the clean up costs to date, and the governmental authorities have not identified Industries or BATUS as PRPs. Windward also separately, and indirectly, indemnified Appleton in respect of the clean-up costs.

A trial is currently scheduled to begin in Wisconsin on 21 February 2012 to determine whether NCR/Appleton is liable for the clean-up costs in the upper portion of the Fox River. This trial is expected to address issues as to whether NCR/Appleton is liable as a result of the sale, by a predecessor of NCR's Appleton Papers Division, of scrap paper, or "broke", to other paper companies which in turn discharged PCBs into the river in the course of recycling the broke.

Industries has become aware that Windward settled the majority of Appleton's insurance claims (over which it had control) at what Industries believes constituted a significant discount, and has made dividend payments to its former and current shareholders of approximately US\$810 million, leaving it holding, according to its latest accounts, approximately US\$100 million of net assets. Accordingly, there may be a greater risk that the assets of Windward are insufficient to meet its obligations under the indemnities.

Industries believes it has been granted Appleton's own accounts indicate limited financial resources.

In December 2011, Windward asserted that it did not indemnify Industries pursuant to the terms of the 1990 Demerger Agreement in respect of Industries' obligations under the Settlement Agreement. Industries disputes Windward's position and has commenced proceedings.

While Industries believes it may have defences to claims by NCR against it under the Settlement Agreement and arbitration award and remains hopeful that Appleton and the AWA Entities will satisfy their obligations with respect to the Fox River cleanup, taking into account court decisions, sums paid to date on the clean-up and other available information, Industries believes it may have an exposure of some US\$426 million (equivalent to £274 million) in clean up related costs. Accordingly, Industries has made a provision of £274 million, which has been treated as an adjusting item in the income statement. This figure is necessarily subject to uncertainty.

Industries has become aware that NCR is also being pursued by Georgia-Pacific LLC (Georgia-Pacific), the owner of a facility on the Kalamazoo River in South-West Michigan which released PCBs into that river. Georgia-Pacific has been designated as a PRP in respect of that river. Georgia-Pacific contends that NCR is responsible for, or should contribute to, the clean-up costs, because (i) a predecessor to NCR's Appleton Paper Division sold "broke" containing PCBs to Georgia Pacific or others for recycling, (ii) NCR itself sold paper containing PCBs to Georgia Pacific or others for recycling, and/or (iii) NCR is liable for sales to Georgia Pacific or others of PCB containing broke by Mead Corporation, which, like the predecessor to NCR's Appleton Papers Division, coated paper with the PCB-containing emulsion manufactured by NCR. Industries understands that NCR does not believe that NCR has any liability in relation to the Kalamazoo River and that it will vigorously contest Georgia-Pacific's claim. Industries itself believes that Industries only has potential exposure under the Settlement Agreement or arbitration award if NCR is unsuccessful in its defence of the claim and it is found that PCB contamination in the Kalamazoo River is due to "broke" supplied by a predecessor of NCR's Appleton Papers Division.

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.

UK-based Group companies

Investments has been served in the following US cases pending at 31 December 2011: one smoking and health class action (Cleary – see above), one class action alleging violations of Kansas antitrust and consumer protection laws (Danc Smith – see below), and two individual actions (Eiser and Perry). Two other cases which had been pending against Investments as at 31 December 2010 were no longer pending as at 31 December 2011 (City of St. Louis – see above, and the US Department of Justice case – see below). The Company and Investments have been served in one individual action alleging misappropriation of novel ideas and breach of contract (Gero), although on 7 November 2011, the trial court dismissed the Company and Investments from the case, which order the plaintiff appealed on 7 December 2011.

30 Contingent liabilities and financial commitments continued

Conduct-based claims

On 22 September 1999, the US Department of Justice brought an action in the US District Court for the District of Columbia against various industry members, including RJRT, B&W, Industries and Investments. Industries was dismissed for lack of personal jurisdiction on 28 September 2000. The government sought to recover federal funds expended in providing healthcare to smokers who have developed diseases and injuries alleged to be smoking-related, and, in addition, sought, pursuant to the Racketeer Influenced and Corrupt Organisations Act (RICO), disgorgement of profits the government contends were earned as a consequence of a RICO 'enterprise'. On 28 September 2000, the federal district court dismissed the portion of the claim which sought recovery of federal funds expended in providing healthcare to smokers who have developed diseases and injuries alleged to be smoking-related. The non-jury trial of the RICO portion of the claim began on 21 September 2004, and ended on 9 June 2005. On 17 November 2004, the US Court of Appeals for the DC Circuit heard an appeal by the defendants against an earlier district court decision that disgorgement of profits is an appropriate remedy for the RICO violations alleged by the government. On 4 February 2005, the DC Circuit allowed the appeal, ruling that the government could not claim disgorgement of profits. On 17 October 2005, the US Supreme Court declined to hear the appeal by the US government in respect of the claim for disgorgement of US\$280 billion of past profits from the defendants.

On 17 August 2006, the federal district court issued its Final Judgment and Remedial Order, consisting of some 1,600 pages of factual findings and legal conclusions. The court found in favour of the government, and against certain defendants, including RJRT, B&W and Investments. The court also ordered a wide array of injunctive relief, including a ban on the use of 'lights' and other similar descriptors. In addition, the Final Judgment and Remedial Order ordered the defendants to pay the government's costs, which were US\$1.9 million plus interest.

On 10 August 2007, the defendants filed their initial appellate briefs to the Court of Appeals for the DC Circuit. All defendants filed a joint appellate brief, and Investments also filed its own brief which raised the issue of whether Congress intended for RICO to apply to extraterritorial conduct by a foreign defendant. On 19 November 2007, the government filed its opposition and cross-appeal brief, seeking to reinstate certain remedial relief, including its disgorgement claims. On 22 May 2009, a three-judge appellate panel unanimously affirmed the federal district court's RICO liability judgment against Investments, Altria, Philip Morris, RJRT and Lorillard, ordered the dismissal of Counsel for Tobacco Research (CTR) and Tobacco Institute (TI) (two defunct US trade associations that were not covered by the district court's injunctive remedies), and remanded for further factual findings and clarification as to whether liability should be imposed against B&W, based on changes in the nature of B&W's business operations. The panel also remanded on four discrete issues relating to the injunctive remedies, including for the district court "to reformulate" the injunction on the use of low-tar descriptors "to exempt foreign activities that have no substantial, direct, and foreseeable domestic

effects". The government's cross-appeal seeking disgorgement of past profits and the funding of smoking education and cessation programmes was denied. Investments' petition for panel rehearing and rehearing en banc was filed on 31 July 2009 and was denied on 22 September 2009 by the DC Circuit.

On 19 February 2010, the defendants and the government filed certioran petitions with the US Supreme Court. On 28 June 2010, the US Supreme Court declined to grant certioran on all petitions. On 23 July 2010, Investments filed a petition for rehearing of its certioran petition before the US Supreme Court, on the basis of an intervening decision by the US Supreme Court that invalidated the "effects" test the federal district court and DC Circuit both used in concluding that the RICO statute applied to Investments' foreign conduct. The US Supreme Court denied Investments' rehearing petition on 3 September 2010.

On 7 July 2010, the DC Circuit issued its remand returning the case to the federal district court for further proceedings. At a status conference on 20 December 2010, the CTR and the TI were dismissed by consent of the parties and B&W was deemed "not to be a defendant" and was therefore not subject to the Final Judgment and Remedial Order.

On 28 December 2010, the government filed a motion to compel Investments to comply with injunctive remedies being sought in the case. On 21 January 2011, Investments filed its brief in opposition and its motion for reconsideration of the liability judgment and remedial relief against it based on intervening change in controlling law governing the extraterritorial application of US statutes. The government filed its reply in support of its motion to compel and its opposition to Investments' motion for reconsideration on 7 February 2011. Investments filed its reply in further support of its motion for reconsideration on 21 February 2011.

On 28 March 2011, the federal district court issued an opinion granting Investments' motion for reconsideration in part and denying it in part and granting the government's motion to compel in part and denying it in part. The district court determined that a decision by the US Supreme Court in an unrelated case issued several years after the district court's 2006 Final Judgment and Remedial Order, "rejected the 'effects' test for extraterritorial application", and therefore "invalidated the sole basis for [Investment's] liability" in this litigation. As a result, the district court held that the Final Judgment and Remedial Order no longer applied to Investments prospectively, and for this reason, Investments would not have to comply with any of the remaining injunctive remedies being sought by the government. The district court determined, however, that there was no basis for it to retrospectively modify Investments' obligation to pay the government's costs as a prevailing party under the Final Judgment and Remedial Order, and therefore ordered Investments to contribute its one-sixth share of the government's costs. Investments paid its share of the government's costs (a total of US\$404,243.88 inclusive of interest) on 25 May 2011. (RJRT paid approximately US\$782,000 in costs on behalf of itself and B&W on 28 September 2010.)

Notes on the accounts continued

30 Contingent liabilities and financial commitments continued

The government did not appeal the 28 March 2011 opinion. This means that Investments is no longer in the case and will not be subject to any injunctive relief that the court is expected to order against the remaining US defendants.

In the Danc 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.

Prior discovery disputes involving Investments have now been resolved by motion and fact discovery is now closed. In late October 2010, the parties participated in a court-ordered mediation but the case was not resolved. In late October and early November 2010, all defendants, including Investments, moved for summary judgment. 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 nonresident (such as Investments) that did not purchase, sell or manufacture goods in the state of Kansas. The defendants' summary judgment motions were heard on 18 January 2012 and the Court reserved ruling.

On 22 July 2011, the plaintiff filed his own summary judgment motions. These will be briefed and argued, if necessary, after a decision on the defendants' summary judgment motions is issued. If the case is not dismissed on summary judgment, trial of the matter is scheduled to begin on 16 July 2012.

In December 2011, the plaintiff filed a motion to file a second amended petition. The defendants' arguments in opposition to this motion were heard on 18 January 2012 and the Court reserved ruling.

Product liability outside the United States

At 31 December 2011, active claims against the Group's companies existed in 17 markets outside the US (2010: 22) but the only markets with more than five claims were Argentina, Brazil, Canada, Italy, Nigeria, and the Republic of Ireland (2010: seven). Medical reimbursement actions are being brought in Canada, Argentina, Brazil, Israel, Nigeria, Saudi Arabia and Spain.

(a) Medical reimbursement cases

Argentina

In 2007, the non-governmental organisation the Argentina Tort Law Association (ATLA) brought a reimbursement action against Nobleza Piccardo S A I C y F (Nobleza) and Massalín Particulares. A defence was filed by Nobleza on 1 October 2009. Nobleza and the federal government's preliminary objections were considered by the Civil Court in late 2009 and, on 23 December 2009, the Civil Court declared its lack of jurisdiction to hear the claim. On 11 March 2010, the case was sent to the Contentious-Administrative Court, which determined that it had jurisdiction over the case. On 24 June 2011, the Contentious-Administrative Court issued an Order stating that it would decide defendants' outstanding procedural objections

together with the merits of the case. The case will now enter the evidentiary stage.

Brazil

In August 2007, the São Paulo Public Prosecutors 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.

Canada

In Canada there are four pending statutory actions for recovery of healthcare costs arising from the treatment of smoking and health related diseases. These proceedings name various group companies. Legislation enabling provincial governments to recover the healthcare costs has been enacted in all 10 provinces and two of three territories in Canada but has only been proclaimed into force in British Columbia, New Brunswick, Newfoundland and Labrador, Ontario and Quebec. Actions have begun against various Group companies, including Imperial, in British Columbia, New Brunswick, Newfoundland and Labrador, and Ontario. In Quebec, three Canadian manufacturers, including Imperial, are challenging the legislation and the Quebec government has yet to issue a statement of claim.

The government of British Columbia brought a claim pursuant to the provisions of the Tobacco Damages and Health Care Costs Recovery Act 2000 (the Recovery Act) against domestic and foreign 'manufacturers' seeking to recover the plaintiff's costs of healthcare benefits. Imperial, Investments, Industries and other former Rothmans Group companies are named as defendants. The constitutionality of the Recovery Act was challenged by certain defendants and, on 5 June 2003, the British Columbia Supreme Court found the Recovery Act to be beyond the competence of the British Columbia legislature and, accordingly, dismissed the government's claim. The government appealed the decision to the British Columbia Court of Appeal which, on 20 May 2004, overturned the lower court's decision and declared the Recovery Act to be constitutionally valid. The defendants appealed to the Supreme Court of Canada in June 2005 and the court gave its judgment in September 2005 dismissing the appeals and declaring the Act to be constitutionally valid.

The federal government was enjoined by a Third Party Notice and presented a motion to strike out the claim. The hearing took place during the week of 3 March 2008 and the court found in favour of the federal government. The defendants appealed that decision and the hearing was held during the week of 1 June 2009. On 8 December 2009, the British Columbia Court of Appeal handed down its decision in both this case and the Knight class action (see below). This appeal was granted in part. The Court of Appeal held that it was not "plain and obvious" that the federal government did not owe a duty of care to tobacco manufacturers or consumers when it implemented its tobacco control strategy.

30 Contingent liabilities and financial commitments continued

On 8 February 2010, the federal government sought leave to appeal this decision to the Supreme Court of Canada. On 10 March 2010, the defendant filed response materials and a cross appeal. The government of British Columbia sought leave to oppose the defendants' cross appeal in part. On 20 May 2010, the Supreme Court of Canada granted leave to appeal both in respect of the federal government's application and the defendants' conditional cross applications. The appeal was heard on 24 February 2011. On 29 July 2011, the Supreme Court of Canada delivered its opinion, which struck out the third party claims against the federal government.

The underlying medical reimbursement action remains at a preliminary case management stage. Damages have not yet been quantified by the plaintiff. Given the 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 has been postponed and no trial date is currently set.

Non-Canadian defendants challenged the personal jurisdiction of the British Columbia Court and those motions were heard in the Supreme Court of British Columbia. On 23 June 2006, the court dismissed all defendants' motions, finding that there is a "real and substantial connection" between British Columbia and the foreign defendants. Subsequently, the defendants were granted leave to appeal that ruling to the Court of Appeal of British Columbia. The appeal was dismissed on 15 September 2006. The defendants filed leave to appeal to the Supreme Court on 10 November 2006, and that application was denied on 5 April 2007.

The government of New Brunswick has brought a medical reimbursement claim against domestic and foreign tobacco 'manufacturers', pursuant to the provisions of the Recovery Act passed in that Province in June 2006. The Company, Investments, Industries, Carreras Rothmans Limited (the UK Companies) and Imperial have all been named as defendants. The government filed a statement of claim on 13 March 2008. The Group defendants were served with the Notice of Action and Statement of Claim on 2 June 2008. A case management conference was held on 8 January 2009 so that other defendants could challenge the use of a contingent fee arrangement (CFA) for the plaintiff's lawyer. This challenge was refused at first instance. Leave to appeal was granted on limited grounds. These grounds, upon which leave was denied, were appealed directly to the Supreme Court of Canada. On 13 May 2010, the New Brunswick Court of Appeal dismissed Imperial's appeal. The Supreme Court of Canada subsequently denied leave on all aspects of the CFA challenge, thus ending this preliminary challenge. The appeal was dismissed and an application to appeal to the Supreme Court was denied on 21 October 2010.

The UK Companies' challenge to the New Brunswick court's jurisdiction was heard in June 2010. The court of Queen's Bench dismissed the UK Companies' jurisdictional motions on 15 November 2010. The UK Companies sought leave to appeal this decision in the Court of Appeal of New Brunswick, which leave was denied on 11 April 2011 by a single judge of the Court of Appeal. The UK Companies' applications for leave to appeal the 11 April 2011 decision of the Court of Appeal of New Brunswick were

dismissed by the Supreme Court of Canada on 13 October 2011. No damages have yet been quantified by the plaintiff. The UK Companies filed demands for particulars on 15 November 2011.

The government of the Province of Ontario has also filed a C\$50 billion medical reimbursement claim against domestic and foreign tobacco 'manufacturers', pursuant to the provisions of the Tobacco Damages and Health Care Costs Recovery Act 2009. The UK Companies have all been named as defendants. Imperial was served on 30 September 2009 and the UK Companies were served on 8 October 2009. A case management judge has been appointed and the hearing on the UK Companies' jurisdiction motions commenced on 23 November 2011. The jurisdiction motion was heard in November 2011. Judgment was handed down on 4 January 2012 in favour of the plaintiff in respect of all the UK Companies. The effect of this order is that the court has determined that it has jurisdiction to hear the claim against the UK Companies. There is however an automatic right to appeal the judgment to the Court of Appeals.

The government of the Province of Newfoundland and Labrador filed a health care reimbursement claim in February 2011 against domestic and foreign tobacco 'manufacturers', pursuant to the provisions of the Tobacco Health Care Costs Recovery Act enacted in that Province. The UK Companies have all been named as defendants. Imperial was served on 1 April 2011, and the UK Companies were served on 22 March 2011. A case management judge has been appointed. The UK Companies have challenged the personal jurisdiction of the Newfoundland and Labrador court. These jurisdictional challenges are currently scheduled for hearing in May 2012.

Colombia

A medical reimbursement action pending as at 31 December 2010 against British American Tobacco (South America) Limited in Colombia was dismissed on 10 June 2011.

Israel

In Israel, a medical reimbursement claim was brought against Industries, B&W, Investments and B A T (U K and Export) Limited (BATUKE), amongst others, by Clalit Health Services. The plaintiff claimed damages of NIS7.6 billion and sought injunctive relief. On 13 July 2011, the Israeli Supreme Court reversed the trial court's ruling and dismissed the lawsuit on the grounds of remoteness. On 28 August 2011, the plaintiff filed a petition for the holding of an additional hearing before an expanded bench of the Supreme Court. A response on behalf of the Group company defendants was filed by 27 November 2011. The Supreme Court denied the plaintiff's petition for an additional hearing on 28 January 2012. The case is now closed.

Nigeria

Medical reimbursement actions have also been brought by eight Nigerian states (Lagos, Kano, Gombe, Oyo, Akwa Ibom, Ogun, Ondo and Ekiti) and by the federal government of Nigeria, each seeking the equivalent of billions of pounds sterling for costs allegedly incurred by the state and federal governments in treating smoking-related illnesses. British American Tobacco (Nigeria) Limited (BAT Nigeria) has been named as a defendant in each of the cases, the Company and Investments have been named as defendants in seven of the cases.

Notes on the accounts continued

30 Contingent liabilities and financial commitments continued

On 9 October 2009, the actions that had been filed by the Attorneys General of Ondo State and of Ekiti State were voluntarily discontinued by the plaintiffs without prejudice to refile by notices dated 5 October 2009 and 18 June 2009, respectively. The action filed by the Attorney General of Akwa Ibom was struck out without prejudice on 19 October 2009 for lack of prosecution.

On 21 February 2008, the Lagos action was voluntarily discontinued by the plaintiffs. On 13 March 2008, the Lagos Attorney General filed a substantially similar action which was marked as "qualified" under Lagos State's "Fast-Track" system, seeking approximately £10.9 billion in damages, including special, anticipatory and punitive damages, restitution and disgorgement of profits, as well as declaratory and injunctive relief. The "Fast-Track" system provides for resolution of the dispute within an eight-month time-period after filing. BAT Nigeria, the Company and Investments have all been served in the new action, and have filed preliminary objections. At a hearing on 16 September 2008, the court directed that the case no longer qualified to be heard on the "Fast Track" because service was yet to be completed on other non-BAT defendants. On 18 September 2009, the court issued a ruling denying the preliminary objections filed by the Company and Investments on the basis that the court was competent to hear the case as it related to the Company and Investments, that the Company and Investments are necessary parties to the action and that the suit therefore was not liable to be struck out as against the Company and Investments. On 2 October 2009, the Company and Investments filed notices of appeal from the entirety of the court's ruling as it related to their respective objections. The Company and Investments filed their appeal briefs and, on 8 February and 6 July 2011, respectively, the plaintiff filed responding briefs in these appeals with motions for extensions of time. As at 31 December 2011, the appeals and plaintiff's motions for extensions of time remain pending before the Court of Appeal. On 15 October and 19 October 2009, respectively, the Company and Investments filed motions to stay all proceedings pending the resolution of their appeals, which motion was granted by the High Court on 20 September 2010. On 15 June 2011, the Lagos Attorney General filed a notice of appeal from the High Court's order granting a stay of proceedings, which remains pending as at 31 December 2011.

On 8 July 2008, the High Court of Gombe State issued a ruling on the preliminary objections filed by the Company, Investments and other defendants in the case, setting aside the service on all defendants and striking out the Gombe suit. In its decision, the court held that the writs served on the defendants were invalid, the plaintiff had failed to pay the requisite filing fees, and based on these filing defects, the court was not competent to assume jurisdiction. The court also stated, however, that the plaintiff, through its statement of claim and affidavit evidence filed in support of its ex parte motion for leave to serve outside the jurisdiction, had satisfied the requirements for service outside the jurisdiction. Although the plaintiff has not appealed from the court's decision, the plaintiff has filed a renewed action in the High Court of Gombe State. The plaintiff seeks approximately £2.4 billion in damages, including special, anticipatory and punitive damages, restitution and disgorgement of profits, as well as declaratory and injunctive

relief. BAT Nigeria, the Company and Investments filed notices of preliminary objection in the renewed action. On 10 February 2011, the High Court denied the preliminary objections filed by the Company and Investments and the companies appealed the court's ruling on 24 February 2011. The companies also filed motions to stay proceedings in the High Court pending the appeals, and on 19 December 2011 the High Court adjourned sine die pending resolution of the defendants' appeals. On 8 July 2011, the Company and Investments filed their respective appeal briefs and their appeals remain pending as at 31 December 2011.

Oyo State seeks approximately £1.5 billion in damages, including special, anticipatory and punitive damages, restitution and disgorgement of profits, as well as declaratory and injunctive relief. The High Court partially granted the preliminary objections filed by the Company and Investments on 22 June 2010 and set aside the service of the writ of summons. The Company and Investments appealed the court's order insofar as it denied the remainder of the relief requested, including the High Court's decision not to set aside the issuance of the writ. As at 31 December 2011, the Court of Appeal has yet to set a date for hearing of the appeals.

In Kano, the plaintiff seeks approximately £7.6 billion in damages, including special, anticipatory and punitive damages, restitution and disgorgement of profits, as well as declaratory and injunctive relief. Preliminary objections filed by the Company and Investments were dismissed on 16 April 2010. The Company and Investments have appealed the decision and sought a stay of proceedings in the High Court pending appeal. On 13 May 2010, the plaintiff filed a motion in the High Court for preliminary injunctive relief, seeking, inter alia, orders to restrain the defendants from various alleged marketing and distribution practices in Kano State including the sale of tobacco products within 1,000 metres of any public places that are predominately a location for minors. On 3 February 2011, the Company and Investments filed motions in the Court of Appeal to stay further proceedings in the High Court. On 14 February 2011, the plaintiff moved to dismiss the stay motions filed by the Company and Investments before the Court of Appeal. The Court of Appeal hearing on the stay motions filed by the Company and Investments and the plaintiff's motions to dismiss was adjourned on 26 January 2012. No new hearing date has been set. As at 31 December 2011, no date has been set for continuation of proceedings in the High Court.

In Ogun, the preliminary objections filed by BAT Nigeria, the Company and Investments were denied by the court on 20 May 2010. All three BAT defendants have filed appeals and the Company and Investments have sought a stay of proceedings pending their appeals. On 24 May 2010, the plaintiff filed a motion for preliminary injunctive relief in the High Court, seeking, inter alia, orders to restrain the defendants from committing various alleged marketing and distribution practices in Ogun State, including the sale of tobacco products within 1,000 metres of any public places that are predominately a location for minors. On 21 October 2010, the High Court adjourned proceedings sine die pending resolution of the defendants' stay motions before the Court of Appeal. On 18 October 2011, the Court of Appeal set 8 May 2012 for hearing of the Company's appeal and reserved hearing of the Company's stay motion. BAT Nigeria's and Investments' appeals stand adjourned to 30 May 2012 for hearing of the Ogun Attorney General's motions for extensions of time to file responding briefs on appeal.

30 Contingent liabilities and financial commitments continued

The Attorney General of the Federation filed suit on 6 November 2007 against the Company, Investments, BAT Nigeria and two other defendants, seeking approximately £21.3 billion in damages, including special, anticipatory and punitive damages, restitution and disgorgement of profits, as well as declaratory and injunctive relief. The Company, BAT Nigeria, and Investments, respectively, were served on 16, 18, and 19 December 2007, and filed preliminary objections. On 27 January 2010, the Attorney General of the Federation filed a notice of discontinuance of the action as against another defendant, and the court struck out the action as against that defendant.

Saudi Arabia

In Saudi Arabia, in 2007 there were reports that the Ministry of Health was pursuing a medical reimbursement action in the Riyadh General Court against a number of distributors and agents. According to these reports, the Ministry of Health would reportedly seek damages of at least 127 billion Saudi Riyals. As at 31 December 2011, no Group company has been served with process. A separate medical reimbursement action was reportedly filed by the King Faisal Specialist Hospital in the Riyadh General Court, naming 'BAT Company Limited' as a defendant. As at 31 December 2011, no Group company had been served with process in the action.

Spain

In early 2006, the Junta de Andalucía, in Spain, filed a medical reimbursement action against the State and tobacco companies (including BAT España S.A.) before the contentious-administrative courts. The State filed preliminary objections to the Junta's claim, with tobacco companies filing supporting briefs. The court upheld these preliminary objections and dismissed the claim in November 2007. The Junta's appeal of this ruling to the Supreme Court was dismissed in September 2009. However, in May 2009, the Junta filed a new contentious-administrative claim with similar allegations. The defendants filed procedural objections, which were rejected by the court. The next procedural step is for the Junta to file its exhibits to the claim which were not attached to the Writ.

(b) Class actions

Brazil

There are currently four class actions being brought in Brazil. One class action recently ended in a final defence judgment (see below). One is also a medical reimbursement (São Paulo), and is therefore discussed above.

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 on 7 April 2004. That lower court decision 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 Office. On 20 December 2011, the Public Prosecutor 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. The appellate court has not yet issued a ruling.

The Brazilian Association for the Defense of Consumers' Health (Saudecon) filed a class action against Souza Cruz 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 Prosecution 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 Prosecution 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 Prosecution Office special appeal, ordering the remittance of the case records in the first instance to complete proper notification to the Public Prosecutor Office of the sentence. On 14 December 2011, the Public Prosecution Office filed a special appeal. Souza Cruz's counter-arguments were submitted on 10 February 2012.

A class action was filed against Souza Cruz by the Association of Exploited Consumers of the federal District, requesting a court order to prevent Souza Cruz selling cigarettes in Brazil. In December 2006, the federal District Court of Appeals confirmed a favourable lower court decision which had found the claim groundless and unlawful. The plaintiff appealed that ruling, but on 12 March 2009 the Superior Court affirmed the ruling and rejected the plaintiff's appeal. The plaintiff appealed again, but on 23 March 2009, in a unanimous decision, the Superior Court rejected the plaintiff's appeal. On 25 November 2011, the Reporting Justice confirmed the Superior Court of Justice and the Federal District State Court of Appeals favourable decisions. The case is now closed.

Notes on the accounts continued

30 Contingent liabilities and financial commitments continued

In 2004, the State of Sergipe instigated a class action seeking compensation for smokers in Sergipe State who purportedly tried to quit smoking. The lower court denied the plaintiffs' request for early relief and determined ANVISA (a federal government health agency) be ordered to join the case as co-defendants. As ANVISA is a federal agency, the case was removed to the federal court where ANVISA successfully argued that it lacked standing to be sued. The claim against ANVISA was dismissed and the federal court sent the case back to the lower state court for proceedings to continue. However, the action was stayed on 18 December 2009 pending a decision by the Superior Court on which court has jurisdiction. On 26 March 2010 the Superior Court determined that the civil court had jurisdiction of the matter. On 19 October 2011, the court dismissed the action with judgment on the merits. The plaintiff filed an appeal on 9 January 2012.

Bulgaria

In March 2008, Mr Nikolay Benchev Yochkolovski filed a smoking-related consumer fraud class action in the Sofia City Court of Bulgaria against 21 defendants, including the following British American Tobacco-affiliated companies: British-American Tobacco Polska S A, British-American Tobacco (Romania) Investments SRL, House of Prince A/S, and Scandinavian Tobacco S A. On 24 September 2008, the claim was dismissed on procedural grounds and the plaintiff appealed this ruling. On 11 November 2008, the Court of Appeal granted the plaintiff's appeal. On 2 December 2008, the Sofia City Court ordered the plaintiff to meet various evidentiary and procedural conditions before proceeding further with this claim. The Sofia Court of Appeal upheld this decision. Following a hearing before the Sofia City Court, the court denied the plaintiff's request to allow a class action to proceed on 26 November 2010. The plaintiff appealed that decision and on 20 January 2011, the Sofia Court of Appeal, rejected plaintiff's appeal and affirmed termination of the proceedings. Thereafter, the plaintiff appealed the decision to the Bulgarian Supreme Court of Cassation. The Court rejected this appeal on 3 May 2011.

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 Impenal.

The Supreme Court of British Columbia certified a class of all consumers of cigarettes bearing 'light' or 'mild' descriptors since 1974 manufactured in British Columbia by Impenal. Impenal filed an appeal against the certification which was heard in February 2006. The appellate court confirmed the certification of the class but has limited any financial liability, if proven, to the period from 1997.

The motion of the federal government to strike out the third party notice issued against them by Impenal was heard in February 2006 and was granted but was appealed by Impenal. The appeal was

heard in June 2009 in conjunction with the British Columbia health care reimbursement claim. The Court of Appeal went so far as to say that it was not "plain and obvious" that the federal government did not owe a duty of care to manufacturers or indeed to the class itself and, therefore, the federal government could face potential liability to claims of product liability or misrepresentation. The federal government appealed the Court of Appeal's decision. On 29 July 2011, the Supreme Court unanimously granted the federal government's appeal and dismissed the third party claim on the basis that the federal government's impugned conduct constituted valid policy benefiting public health and is therefore not subject to civil liability.

On 9 December 2009, Impenal was served with a class action filed by Ontario tobacco farmers and the Ontario Flue-Cured Tobacco Growers' Marketing Board (the Growers' Claim). The plaintiffs allege that, during the timeframe, Impenal improperly paid lower prices for tobacco leaf destined for duty-free products that was smuggled back into Canada and sold in the domestic market, as opposed to the higher domestic leaf price. Impenal deposited the amount owing to the government of Ontario pursuant to the Comprehensive Agreement into an escrow account, alleging that the Comprehensive Agreement permitted Impenal 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 Impenal, seeking the release of the funds (the Ontario Claim). No monetary damages are being claimed against Impenal by the government of Ontario.

On 26 July 2010, Impenal argued its preliminary motion in the Ontario claim. Impenal was successful in its application and the court ordered that the Ontario claim be stayed in favour of the arbitration provisions stipulated in the Comprehensive Agreement and raised by Impenal in its Notice of Arbitration. The Ontario government appealed this decision and the hearing date originally scheduled for 4 January 2011 was heard by the Ontario Court of Appeal on 17 February 2011. The Canadian government intervened in the appeal to support the Ontario government's position.

On 20 July 2011, the Court of Appeal gave judgment in Impenal's favour and held that the funds would remain in escrow pending a decision by an arbitrator on the issue pursuant to the Comprehensive Agreement. The court 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. In the meantime, Impenal will proceed with the arbitration. As yet, no hearing date has been set.

Impenal was recently served with certification materials in the underlying Growers' Claim. This case remains at a very preliminary stage and no hearing date has been set.

There are currently two class actions in Quebec. On 21 February 2005, the Quebec Superior Court granted certification in two class actions against Impenal and two domestic manufacturers, which have a combined value of C\$23 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 at November 1998 or developed these diseases thereafter and who smoked a minimum of fifteen cigarettes a day for at least five years, and residents who were addicted to nicotine at the time the proceedings were filed and who have since remained addicted. In

30 Contingent liabilities and financial commitments continued

Quebec, there is no right of appeal for a defendant upon certification. The plaintiffs have served a Statement of Claim. The trial in this matter has been set for 5 March 2012.

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 UK companies have been released from the action. In Nova Scotia the proceedings have not progressed. There are service issues in relation to the UK Companies for Alberta and Manitoba.

In June 2010, two further suits were filed in British Columbia. Imperial was served with the British Columbia suits on 16 July 2010. 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 were served on 20 July 2010. The UK Companies and Imperial proceeded to challenge jurisdiction.

Italy

In 2010, British American Tobacco Italia S.p.A. (BAT Italia) was served with notice of a class action suit filed by an Italian consumer association (Codacons) and three representative individuals. The main allegations made in the class action relate to addiction claims and failure to warn. In April 2011, the class action suit was declared inadmissible by the First Instance Civil Court of Rome. The Court of Rome considered the action to be manifestly without merit and held that it was inadmissible on that basis as well as others. Plaintiffs filed an appeal against the decision issued by the Court of Rome, challenging the grounds of inadmissibility. The parties presented their final arguments to the Court of Appeal on 25 January 2012. On 27 January 2012, the Court of Appeal upheld the lower court's decision confirming the inadmissibility 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. A new date has yet to be scheduled by the court.

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. The court must therefore decide whether Cigarrera Bigott's intervention may be admitted under the new procedure prior to the public hearing. This decision has not yet been issued.

(c) Individual personal injury claims

Aside from the US there are approximately 353 individual smoking cases pending world-wide as at 31 December 2011 against Group companies that are not detailed here. Over three-quarters of these cases are in Brazil.

At 31 December 2011, there were only three (compared to approximately 1,000 cases in July 2008, which decreased to 634 in July 2009) individual 'lights' cases in Italy pending against BAT Italia before the justice of the peace courts and 43 'lights' cases on appeal. In addition, in 2007, 2,230 cases were filed by a single plaintiff's counsel in one jurisdiction (Pescopagano). The court has confirmed the withdrawal of all of these claims. Because of the type of court involved, the most that any individual plaintiff can recover in damages is €1,033, plus €1,000 in costs and an additional €3,000 for enforcement proceedings. As at 31 December 2011, more than 4,000 cases (including 2,230 Pescopagano cases) had been withdrawn, suspended or resulted in decisions given in favour of BAT Italia.

As at 31 December 2011, there are 27 smoking and health cases pending before Italian first instance civil courts, filed by or on behalf of individuals in which it is contended that diseases or deaths have been caused by cigarette smoking. There are two labour cases for alleged occupational exposure pending in Italy. In addition, there are 12 cases on appeal, including two appeals that relate to the same labour court decision (Serafini) but based on different grounds.

On 23 June 2003, an individual action was brought in the Danish High Court against House of Prince A/S and Skandinavisk Tobakskompagni A/S seeking DKK485,450 (currently approximately €65,215) for alleged smoking-related diseases and loss of earnings. On 8 December 2011, the Court issued judgment in favour of the defendants and ordered costs against the plaintiff. On 31 January 2012, the plaintiff filed an appeal.

On 14 September 2011, an individual action was brought in the Zheleznodorozhny District Court of Khabarovsk, Russia against British American Tobacco-STF (BAT-STF) and British American Tobacco-Yava (BAT-Yava) among others. The plaintiff seeks to compel defendants, including BAT-STF and BAT-Yava, to cease production and sale of tobacco products and to remove their tobacco products from circulation within the Russian Federation. On 20 October 2011, a statement of defence was filed for BAT-STF and BAT-Yava. The plaintiff filed to withdraw his claim and the court accepted the withdrawal of the claim on 22 November 2011. The plaintiff did not file an appeal within the time permitted. However, the plaintiff may still be allowed to file an appeal if he can show that there was a valid reason for missing the appeal deadline.

Notes on the accounts continued

30 Contingent liabilities and financial commitments continued

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, the Group (i) does not consider it appropriate to make any provision in respect of any pending litigation, save insofar as stated above and (ii) does not believe that the ultimate outcome of this litigation will significantly impair the Group's financial condition.

30 Contingent liabilities and financial commitments continued

Operating leases

Total future minimum lease payments under non-cancellable operating leases comprise leases where payments fall due

	2011 £m	2010 £m
Property		
Within one year	70	59
Between one and five years	183	149
Beyond five years	129	122
	382	330
Plant and equipment		
Within one year	31	26
Between one and five years	47	25
	78	51

Five Year Summary

For the years ended 31 December	2011 £m	2010 £m	2009 £m	2008 £m	2007 £m
Income statement					
Gross turnover (including duty, excise and other taxes)	46,123	43,855	40,713	33,921	27,104
Revenue (after deducting duty, excise and other taxes)	15,399	14,883	14,208	12,122	10,018
Profit from operations	4,721	4,318	4,101	3,572	2,904
Adjusted profit from operations	5,519	4,984	4,461	3,717	3,002
Profit before taxation	4,931	4,388	4,080	3,684	3,077
Profit for the year	3,375	3,140	2,956	2,659	2,287
Earnings per share					
	2011 pence	2010 pence	2009 pence	2008 pence	2007 pence
– basic unadjusted	157.1	145.2	137.0	123.3	105.2
– diluted unadjusted	156.2	144.4	136.3	122.5	104.5
– diluted adjusted	194.6	175.7	153.0	128.8	108.5
Dividends declared per share	126.5	114.2	99.5	83.7	66.2
At 31 December					
	2011 £m	2010 £m	2009 £m	2008 £m	2007 £m
Balance sheet					
Non-current assets	18,624	19,203	18,508	18,812	13,399
Current assets	8,495	8,657	8,106	8,739	5,365
Total assets	27,119	27,860	26,614	27,551	18,764
Owners of the parent	8,167	9,206	7,613	6,944	6,871
Non-controlling interests	307	342	299	271	218
Total equity	8,474	9,548	7,912	7,215	7,089
Non-current liabilities	10,798	10,667	11,786	11,458	7,131
Current liabilities	7,847	7,645	6,916	8,878	4,544
Total liabilities	18,645	18,312	18,702	20,336	11,675
Total equity and liabilities	27,119	27,860	26,614	27,551	18,764

Half-Yearly Analyses 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

	30 Jun 2011 £m	6 months to 31 Dec 2011 £m	Year to 31 Dec 2011 £m
Profit from operations	2,691	2,030	4,721
Analysed as			
– adjusted profit from operations	2,760	2,759	5,519
– restructuring and integration costs	(40)	(153)	(193)
– amortisation of trademarks	(29)	(29)	(58)
– goodwill impairment		(273)	(273)
– Fox River		(274)	(274)
	2,691	2,030	4,721
Net finance costs	(233)	(227)	(460)
Share of post-tax results of associates and joint ventures	329	341	670
Analysed as			
– adjusted share of post-tax results of associates and joint ventures	315	344	659
– issue of shares and change in shareholding	34	(6)	28
– smoking cessation programme	(23)		(23)
– gain on disposal of business		22	22
– other	3	(19)	(16)
	329	341	670
Profit before taxation	2,787	2,144	4,931
Earnings per share			
Basic	94 5p	62 6p	157 1p
Adjusted diluted	96 1p	98 5p	194 6p

	30 Jun 2010 £m	6 months to 31 Dec 2010 £m	Year to 31 Dec 2010 £m
Profit from operations	2,271	2,047	4,318
Analysed as			
– adjusted profit from operations	2,460	2,524	4,984
– restructuring and integration costs	(158)	(153)	(311)
– amortisation of trademarks	(31)	(31)	(62)
– impairment of trademarks		(44)	(44)
– goodwill impairment		(249)	(249)
	2,271	2,047	4,318
Net finance costs	(231)	(249)	(480)
Share of post-tax results of associates and joint ventures	239	311	550
Analysed as			
– adjusted share of post-tax results of associates and joint ventures	306	316	622
– issue of shares and change in shareholding		(9)	(9)
– Canadian settlements	(60)	1	(59)
– other	(7)	3	(4)
	239	311	550
Profit before taxation	2,279	2,109	4,388
Earnings per share			
Basic	76 9p	68 3p	145 2p
Adjusted diluted	87 1p	88 6p	175 7p

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 per cent of Group revenue and operating profit.

	% equity shares held		% equity shares held
Centre Corporate Companies		Brazil	
B A T (U K and Export) Ltd	100	Souza Cruz S A	75
B A T Capital Corporation (Incorporated in the United States of America)	100*	Canada	
B A T International Finance p l c	100*	Imperial Tobacco Canada Ltd	100
BATMark Ltd	100*	Chile	
British-American Tobacco (Holdings) Ltd	100	British American Tobacco Chile Operaciones S A	98
British American Tobacco Holdings (The Netherlands) B V (Incorporated in The Netherlands)	100	Colombia	
British American Tobacco International Ltd (Incorporated in Switzerland)	100	British American Tobacco (South America) Ltd (Incorporated in the United Kingdom)	100
British American Tobacco (Brands) Inc (Incorporated in the United States of America)	100	Mexico	
British American Tobacco (Brands) Ltd	100	British American Tobacco Mexico, S A de C V	100
British American Tobacco (GLP) Ltd	100	Venezuela	
British American Tobacco (Investments) Ltd	100	C A Cigarrera Bigott Sucrs	100
Tobacco Insurance Company Ltd	100	Western Europe	
Asia-Pacific		Belgium	
Australia		British American Tobacco Belgium S A	100
British American Tobacco Australia Ltd	100	Czech Republic	
Bangladesh		British American Tobacco (Czech Republic), s r o	100
British American Tobacco Bangladesh Company Ltd	65	Denmark	
Indonesia		British American Tobacco Denmark A/S (House of Prince A/S)	100
PT Bentoel Internasional Investama Tbk	85*	France	
Japan		British American Tobacco France SAS	100
British American Tobacco Japan, Ltd	100	Germany	
Malaysia		British-American Tobacco (Germany) GmbH	100
British American Tobacco (Malaysia) Berhad	50	British American Tobacco (Industrie) GmbH	100
New Zealand		Hungary	
British American Tobacco (New Zealand) Ltd	100	BAT Pecs Dohnygyr Kft	100
Pakistan		Italy	
Pakistan Tobacco Co Ltd	94	British American Tobacco Italia S p A	100
South Korea		Netherlands	
British American Tobacco Korea Ltd	100	British American Tobacco Nederland B V	100
British American Tobacco Korea Manufacturing Ltd	100	Poland	
Taiwan		British American Tobacco Polska S A	100
B.A.T Services Ltd (Incorporated in the United Kingdom)	100	British American Tobacco Polska Trading Sp z o o	100
Vietnam		Romania	
British-American Tobacco Marketing (Singapore) Private Limited (Incorporated in Singapore)	100	British-American Tobacco (Romania) Trading SRL	100
Americas		Spain	
Argentina		British American Tobacco España, S A.	100
Nobleza-Piccardo S A I C y F	98	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		% equity shares held
Eastern Europe, Middle East and Africa		Russia	
Algeria		OJSC British American Tobacco – STF	100
British American Tobacco (Algérie) S P A.	51	OJSC British American Tobacco – Yava	99 [†]
Egypt		CJSC British American Tobacco – SPb	100 [†]
British American Tobacco Egypt LLC	100	CJSC “International Tobacco Marketing Services”	100
Iran		South Africa	
B A T Pars Company (Private Joint Stock)	100	British American Tobacco Holdings	
Kazakhstan		South Africa (Pty) Ltd	100
British American Tobacco Kazakhstan Trading LLP	100	Turkey	
Morocco		British American Tobacco Tutun Mamullen Sanayi ve	
British American Tobacco Exports B V	100	Ticaret A S	100
(incorporated in the Netherlands)		Ukraine	
Nigeria		A/T B A T – Prilucky Tobacco Co	99
British American Tobacco (Nigeria) Ltd	100		

Those subsidiary undertakings listed above which are held directly by British American Tobacco p l c are indicated thus *, all others are held by sub-holding companies. Unless otherwise stated, Centre Corporate Companies are subsidiary undertakings incorporated in the United Kingdom and the country of incorporation and operation of regional subsidiary undertakings is that under which the company is listed. All identified subsidiary undertakings are involved in activities related to the manufacture, distribution or sale of tobacco products. All companies' shares are ordinary shares or common stock except for those indicated thus †, which include preference shares.

[†] During 2011, the Group sold 984 million shares, representing approximately 14% of PT Bentoel Internasional Investama Tbk's share capital, for the purposes of fulfilling certain obligations pursuant to Bapepam LK (Indonesia) takeover regulations. The Group simultaneously entered into a total return swap on 971 million of the shares. As a consequence of this and for the duration of the swap, while the Group does not have legal ownership of these shares, it retains the risks and rewards which results in the Group continuing to recognise an effective interest in 99% of PT Bentoel Internasional Investama Tbk's net assets and results.

A complete list of Group subsidiary and associate undertakings will be attached to the next British American Tobacco p l c annual return to the Registrar of Companies. A broader description of the Group's operations and sphere of activities can be found online at www.bat.com.

Principal associate undertakings

		Latest published information	Total issued capital £m	% shares held
Americas				
United States of America				
Reynolds American Inc	▼ Common Stock	31.12.11	*	42
tobacco	▼ Preferred Stock		**	
Asia-Pacific				
India				
ITC Ltd	▼ Ordinary	31.12.11	95	31
FMCG including tobacco				
agri-business				
paperboard, paper and packaging				
hotels				

▼ Listed overseas

* As at 31 December 2011, Reynolds American Inc. had issued 576,135,199 shares (US\$0.0001 Common Stock), of which the Group held 242,230,221

** As at 31 December 2011, Reynolds American Inc. had issued 1,000,000 shares (US\$0.01 Preferred Stock), in which the Group held no interest.

Independent auditors' report

To the members of British American Tobacco p.l.c.

We have audited the Parent Company financial statements of British American Tobacco p.l.c. for the year ended 31 December 2011 which comprise the Parent Company Balance Sheet, and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

Respective responsibilities of Directors and auditors

As explained more fully in the Directors' responsibility statement set out on page 108, the Directors are responsible for the preparation of the Parent Company financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the Parent Company financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report, including the opinions, has been prepared for and only for the Company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of whether the accounting policies are appropriate to the Parent Company's circumstances and have been consistently applied and adequately disclosed, the reasonableness of significant accounting estimates made by the Directors, and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on financial statements

In our opinion the Parent Company financial statements

- give a true and fair view of the state of the Company's affairs as at 31 December 2011,
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice, and
- have been prepared in accordance with the requirements of the Companies Act 2006

Opinion on other matters prescribed by the Companies Act 2006

In our opinion

- the part of the remuneration report to be audited has been properly prepared in accordance with the Companies Act 2006, and
- the information given in the Directors' report for the financial year for which the Parent Company financial statements are prepared is consistent with the Parent Company financial statements


Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion

- adequate accounting records have not been kept by the Parent Company, or returns adequate for our audit have not been received from branches not visited by us, or
- the Parent Company financial statements and the part of the remuneration report to be audited are not in agreement with the accounting records and returns, or
- certain disclosures of Directors' remuneration specified by law are not made, or
- we have not received all the information and explanations we require for our audit.

Other matter

We have reported separately on the Group financial statements of British American Tobacco p.l.c. for the year ended 31 December 2011.


Paul Cragg (Senior Statutory Auditor)
 for and on behalf of PricewaterhouseCoopers LLP
 Chartered Accountants and Statutory Auditors
 London, United Kingdom

22 February 2012

Balance Sheet – British American Tobacco p.l.c.

At 31 December

	Notes	2011 £m	2010 £m
Assets			
Fixed assets			
Investments in group companies	2	4,305	4,302
		4,305	4,302
Current assets			
Debtors	3	7,894	4,693
		7,894	4,693
Total assets		12,199	8,995
Equity			
Capital and reserves			
Called up share capital		506	506
Share premium account		64	61
Capital redemption reserves		101	101
Other reserves		90	90
Profit and loss account		6,669	3,647
after deducting			
– cost of treasury shares		(1,527)	(740)
Shareholders' funds	4	7,430	4,405
Liabilities			
Creditors	5	4,769	4,590
Total equity and liabilities		12,199	8,995

The accompanying notes are an integral part of the Parent Company financial statements

On behalf of the Board



Richard Burrows
Chairman
22 February 2012

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 Practice

The Company is a public limited company which is listed on the London Stock Exchange and the Johannesburg Stock Exchange and is incorporated and domiciled in the UK

Cash Flow Statement

The cash flows of the Company are included in the consolidated cash flow statement of British American Tobacco p l c which is included in this Annual Report. Consequently the Company is exempt under the terms of FRS 1 (Revised) from publishing a cash flow statement.

Foreign Currencies

Transactions arising in currencies other than sterling are translated at the rate of exchange ruling on the date of the transaction. Assets and liabilities expressed in currencies other than sterling are translated at rates of exchange ruling at the end of the financial year. All exchange differences are taken to the profit and loss account in the year.

Accounting for income

Income is included in the profit and loss account when all contractual or other applicable conditions for recognition have been met. Provisions are made for bad and doubtful debts, as appropriate.

Taxation

Taxation provided is that chargeable on the profits of the year, together with deferred taxation. Deferred taxation is provided in full on timing differences between the recognition of gains and losses in the financial statements and their recognition in tax computations.

However, the Company does not discount deferred tax assets and liabilities.

Fixed asset investments

Fixed asset investments are stated at cost, together with subsequent capital contributions, less provisions for any impairment in value.

Dividends

Final dividend distributions to the Company's shareholders are recognised as a liability in the financial statements in the period in which the dividends are approved by the Company's shareholders while the interim dividend distributions are recognised in the period in which the dividends are declared and paid.

Similarly, dividend income is recognised at the same time as the paying company recognises the liability to pay a dividend.

Repurchase of share capital

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

Related Parties

The Company has taken advantage of the exemption under paragraph 3(c) of FRS 8 from disclosing transactions with related parties that are wholly owned subsidiaries of British American Tobacco p l c Group.

Financial instruments

The financial instrument disclosures of the Company are included in the Group financial statements which are included in this Annual Report. Consequently, the Company is exempt under paragraph 2D (b) of FRS 29 from publishing these financial instruments disclosures.

Financial guarantees are recorded at fair value less accumulated amortisation.

2 Investments in Group companies

The Company's directly owned subsidiaries are British American Tobacco (1998) Limited, B.A.T. International Finance p l c, B.A.T. Capital Corporation 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.

	2011 £m	2010 £m
1 January	4,302	4,295
Additions	3	7
31 December	4,305	4,302

3 Debtors

	2011 £m	2010 £m
Amounts due from Group undertakings	7,894	4,693

Included within amounts due from Group undertakings is an amount of £6,348 million (2010: £2,967 million) which is unsecured, interest bearing and repayable on demand. The interest rate is based on LIBOR.

Amounts totalling £1,485 million (2010: £1,673 million) due from Group undertakings are unsecured, interest free and repayable on demand.

Included in debtors are amounts of £61 million (2010: £53 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 2011	506	61	101	90	3,647	4,405
Increase in share capital – share options		3				3
Profit for the year					6,167	6,167
Dividends and other appropriations ordinary shares					(2,358)	(2,358)
Consideration paid for share buy-back programme					(755)	(755)
Consideration paid for purchase of own shares held in employee share ownership trusts					(120)	(120)
Consideration received on the exercise of options over own shares held in employee share ownership trusts					1	1
Other movements					87	87
31 December 2011	506	64	101	90	6,669	7,430

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 2011 is shown in note 8 to the Group financial statements and will be recognised in the financial statements for the year ended 31 December 2012.

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 2011 was £6,167 million (2010: £2,541 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 2011 (2010: four). The cost of these employees are borne by another Group company.

Shareholders' funds are stated after deducting the cost of treasury shares which include £1,278 million (2010: £523 million) for shares repurchased and not cancelled and £249 million (2010: £217 million) in respect of the cost of own shares held in employee share ownership trusts.

During 2011 28 million shares were bought back at a cost of £750 million (2010: £nil), excluding transaction costs of £5 million (2010: £nil).

Notes on the accounts continued

4 Shareholders' funds continued

Called up share capital	Ordinary shares of 25p each Number of shares	£m
Allotted and fully paid		
1 January 2011	2,025,756,358	506.44
Changes during the year		
– share option schemes	230,312	0.06
31 December 2011	2,025,986,670	506.50

Called up share capital	Ordinary shares of 25p each Number of shares	£m
Allotted and fully paid		
1 January 2010	2,025,364,622	506.34
Changes during the year		
– share option schemes	391,736	0.10
31 December 2010	2,025,756,358	506.44

Share premium

The increase of £3 million (2010 £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

	2011 £m	2010 £m
Amounts due to Group undertakings	991	823
Loans due to Group undertakings	3,617	3,617
Sundry creditors	161	150
	4,769	4,590

Amounts due to Group undertakings of £991 million (2010 £823 million) are unsecured, interest free and repayable on demand.

Loans due to Group undertakings of £3,617 million (2010 £3,617 million) are unsecured, bear interest at rates between 1.42 per cent and 2.23 per cent (2010 1.34 per cent and 1.93 per cent) and repayable on demand.

Included in sundry creditors is an amount of £54 million (2010 £47 million) which is unsecured, interest bearing and due within one year and the remaining balance of £107 million (2010 £103 million) is unsecured, interest free and due after one year.

6 Audit fees

	2011	2010
Fees payable to PricewaterhouseCoopers LLP		
– Audit fees	£30,000	£30,000
– Fees paid for other services	£nil	£nil

7 Contingent liabilities and financial commitments

British American Tobacco p.l.c. has guaranteed borrowings by subsidiary undertakings of £9.3 billion (2010 £9.3 billion) and total borrowing facilities of £17.7 billion (2010 £16.3 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 a FRS17 basis at 31 December 2011 of £400 million (2010 £221 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, Bndgwater 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/bn

Access the web-based enquiry service for shareholders operated by Computershare Investor Services in the UK, view details of your British American Tobacco shareholding and recent dividend payments and register for shareholder electronic communications to receive notification of British American Tobacco shareholder mailings by 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. This service is only available to shareholders in countries where settlement can be made in sterling or euros

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 Amex Equities (Symbol BTI, CUSIP No 110448107)

British American Tobacco sponsors an American Depositary Receipt (ADR) programme in the United States. Each ADR represents two of the Company's ordinary shares

Enquiries regarding ADR holder accounts and payment of dividends should be directed to

Citibank Shareholder Services

P O Box 43077, Providence, Rhode Island 02940-3077, USA

tel 1-888 985-2055 (toll-free) or +1 781 575 4555

email enquiries ctibank@shareholders-online.com

website www.cti.com/dr

Publications

Copies of current and past Annual Reports are available on request. Copies of the Group corporate descriptive booklet About Us are also available. Highlights from these publications can be produced in alternative formats such as Braille, audio tape and large print, contact

British American Tobacco Publications

Unit 80, London Industrial Park, Roding Road, London E6 6LS

tel +44 20 7511 7797, facsimile +44 20 7540 4326

email bat@team365.co.uk

Alternatively contact Computershare Investor Services (Pty) Ltd using the contact details shown above

Our website – www.bat.com

Access comprehensive information about British American Tobacco and download shareholder publications at the corporate website, visit the Investor Centre for valuation and charting tools and dividend and share price data and subscribe to the email and SMS alert services for key financial events in the British American Tobacco financial calendar

Dividend Reinvestment Plan

Available to the majority of shareholders on the UK register, this is a straightforward and economic way of utilising your dividends to build up your shareholding in British American Tobacco. Contact Computershare Investor Services in the UK for details

Individual Savings Accounts (ISAs)

A British American Tobacco sponsored ISA. Contact

The Share Centre

PO Box 2000, Aylesbury, Bucks HP21 8ZB

tel 0800 800 008, +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 2011 – dates in 2012

23 February	Dividend announced (including amount of dividend per share in both sterling and rand, applicable exchange rate and conversion date – 21 February 2012)
23 February to 9 March	From the commencement of trading on 23 February to 9 March 2012 (inclusive), no removal requests in either direction between the UK main register and the South African branch register will be permitted
2 March	Last day to trade (JSE)
5-9 March	No transfers between the UK main register and South African branch register, no shares may be dematerialised or rematerialised
5 March	Ex-dividend date (JSE)
7 March	Ex-dividend date (LSE)
9 March	Record date (LSE and JSE)
3 May	Payment date (sterling and rand)
Financial calendar 2012	
26 April	Interim Management Statement
26 April	Annual General Meeting The Banqueting House, Whitehall, London SW1A 2ER
25 July	Half-Yearly Report
24 October	Interim Management Statement

Shareholder and contact information continued

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	£30.68	£22.825
JSE	R397.70	R250.80

At 31 December 2011 there was a total of 2,025,986,670 ordinary shares in issue held by 111,284 shareholders. These shareholdings are analysed as follows

(a) by listing as at 31 December 2011

Register	Total number of shares	Percentage of issued share capital	Number of holders
UK	1,810,487,974	89.36	51,194
South Africa	215,498,696	10.64	60,090

(b) by category of shareholder and size of shareholding as at 31 December 2011 being the date on which equivalent information is available on both registers

UK Register

Category of UK shareholder	Number of UK holders	Percentage of total UK holders	Number of UK ordinary shares	Percentage of UK ordinary share capital
Individuals	42,680	83.37	51,173,090	2.83
Financial institutions/ Pension funds	289	0.56	10,486,323	0.58
Nominee companies	7,893	15.42	1,683,233,673	92.97
Other corporate holders	331	0.65	8,597,126	0.47
Treasury Shares (UK)	1	<0.01	56,997,762	3.15

South African Register

Category of SA shareholder	Number of SA holders	Percentage of total SA holders	Number of SA ordinary shares	Percentage of SA ordinary share capital
Individuals	44,191	73.54	29,527,026	13.70
Financial institutions/ Pension funds	1,405	2.34	137,381,213	63.75
Nominee companies	11,990	19.95	35,876,431	16.65
Other corporate holders	2,504	4.17	12,714,026	5.90

Combined Registers

Category of shareholder	Number of holders	Percentage of total holders	Number of ordinary shares	Percentage of issued ordinary share capital
Individuals	86,871	78.06	80,700,116	3.98
Financial institutions/ Pension funds	1,694	1.52	147,867,536	7.30
Nominee companies	19,883	17.87	1,719,110,104	84.85
Other corporate holders	2,835	2.55	21,311,152	1.05
Treasury Shares (UK)	1	<0.01	56,997,762	2.82

UK Register

	Number of holders	Percentage of UK ordinary share capital
1 – 1,999	42,212	1.17
2,000 – 9,999	6,912	1.43
10,000 – 199,999	1,525	3.87
200,000 – 499,999	213	3.73
500,000 and over	331	86.65
Treasury shares (UK)	1	3.15

South African Register

	Number of holders	Percentage of SA ordinary share capital
1 – 1,999	53,340	8.99
2,000 – 9,999	5,061	9.36
10,000 – 199,999	1,562	26.32
200,000 – 499,999	82	11.94
500,000 and over	45	43.39

Combined Registers

	Number of holders	Percentage of issued ordinary share capital
1 – 1,999	95,552	2.01
2,000 – 9,999	11,973	2.27
10,000 – 199,999	3,087	6.25
200,000 – 499,999	295	4.60
500,000 and over	376	82.06
Treasury shares (UK)	1	2.81

Registered office

Globe House, 4 Temple Place, London WC2R 2PG
tel +44 20 7845 1000, facsimile +44 20 7240 0555

Incorporated in England and Wales No 3407696

Representative Office in South Africa

34 Alexander Street, Stellenbosch 7600, South Africa
PO Box 631, Cape Town 8000, South Africa
tel +27 21 883 3722

Secretary

Nicola Snook

General Counsel

Neil Withington

Investor relations

Enquiries should be directed to Michael Nightingale,
Rachael Brierley or Maya Farhat
tel +44 20 7845 1180

Press office

Enquiries should be directed to Kate Matrunola
or Catherine Armstrong
tel +44 20 7845 2888
e-mail press_office@bat.com

Auditors

PricewaterhouseCoopers LLP
1 Embankment Place, London WC2N 6RH

British American Tobacco p l c. (No 3407696) Annual Report 2011

This is the Annual Report of British American Tobacco p l c (the Company) and the British American Tobacco Group, comprising the Directors' report and the audited financial statements, for the year ended 31 December 2011. It has been drawn up and is presented in accordance with, and reliance upon, applicable English company law. The liabilities of the Directors in connection with this report shall be subject to the limitations and restrictions provided by such law.

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

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

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

Cautionary statement

The business review and certain other sections of the 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.

About this report

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