NOTICE

THIS OFFERING MEMORANDUM IS AVAILABLE ONLY TO INVESTORS WHO ARE EITHER (1) QUALIFIED INSTITUTIONAL BUYERS WITHIN THE MEANING OF RULE 144A UNDER THE U.S. SECURITIES ACT OF 1933, AS AMENDED (THE "SECURITIES ACT") OR (2) PERSONS WHO ARE NOT U.S. PERSONS (AS DEFINED IN REGULATION S UNDER THE SECURITIES ACT) AND WHO ARE OUTSIDE OF THE UNITED STATES IN ACCORDANCE WITH REGULATION S UNDER THE SECURITIES ACT (AND, IF INVESTORS ARE RESIDENT IN A MEMBER STATE OF THE EUROPEAN ECONOMIC AREA, PERSONS WHO ARE QUALIFIED INVESTORS).

IMPORTANT: You must read the following before continuing. The following applies to the offering memorandum following this notice, whether received by email or otherwise received as a result of electronic communication. You are advised to read this disclaimer carefully before reading, accessing or making any other use of the offering memorandum. In accessing the offering memorandum, you agree to be bound by the following terms and conditions, including any modifications to them, each time you receive any information from us as a result of such access.

NOTHING IN THIS ELECTRONIC TRANSMISSION CONSTITUTES AN OFFER OF SECURITIES FOR SALE IN ANY JURISDICTION WHERE IT IS UNLAWFUL TO DO SO. THE SECURITIES HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OR THE SECURITIES LAWS OF ANY STATE OF THE UNITED STATES OR OTHER JURISDICTION AND THE SECURITIES MAY NOT BE OFFERED OR SOLD WITHIN THE UNITED STATES EXCEPT PURSUANT TO AN EXEMPTION FROM, OR IN A TRANSACTION NOT SUBJECT TO, THE REGISTRATION REQUIREMENTS OF THE SECURITIES ACT AND APPLICABLE STATE OR LOCAL SECURITIES LAWS. THE FOLLOWING OFFERING MEMORANDUM MAY NOT BE FORWARDED OR DISTRIBUTED TO ANY OTHER PERSON AND MAY NOT BE REPRODUCED IN ANY MANNER WHATSOEVER. ANY FORWARDING, DISTRIBUTION OR REPRODUCTION OF THIS DOCUMENT IN WHOLE OR IN PART IS UNAUTHORIZED. FAILURE TO COMPLY WITH THIS DIRECTIVE MAY RESULT IN A VIOLATION OF THE SECURITIES ACT OR THE APPLICABLE LAWS OF OTHER JURISDICTIONS.

Confirmation of your representation: In order to be eligible to view the offering memorandum or make an investment decision with respect to the notes, investors must be either (1) qualified institutional buyers within the meaning of Rule 144A under the Securities Act ("QIBs") or (2) persons who are not U.S. persons (as defined in Regulation S under the Securities Act) and who are outside of the United States in offshore transactions in reliance on Regulation S under the Securities Act; provided that investors resident in a Member State of the European Economic Area must be qualified investors (within the meaning of Article 2(1)(e) of Directive 2003/71/EC (the "Prospectus Directive") and any relevant implementing measure in each Member State of the European Economic Area). The offering memorandum is being sent at your request. By accepting this e-mail and by accessing the offering memorandum, you shall be deemed to have represented to us and the initial purchasers set forth in the attached offering memorandum that: (1) you consent to delivery of such offering memorandum by electronic transmission, and (2) either you and any customers you represent are: (a) QIBs, or (b) outside the United States and the e-mail address that you gave us and to which this e-mail has been delivered is not located in the United States, its territories and possessions (including Puerto Rico, the U.S. Virgin Islands, Guam, American Samoa, Wake Island and the Northern Mariana Islands), any State of the United States or the District of Columbia (and if you are resident in a Member State of the European Economic Area, you are a qualified investor within the meaning of the Prospectus Directive). Prospective purchasers that are QIBs are hereby notified that the seller of the notes offered under the offering memorandum may be relying on the exemption from the provisions of Section 5 of the Securities Act provided by Rule 144A under the Securities Act.

You are reminded that the offering memorandum has been delivered to you on the basis that you are a person into whose possession the offering memorandum may be lawfully delivered in accordance with the laws of the jurisdiction in which you are located and you may not, nor are you authorized to, deliver the offering memorandum to any other person. Under no circumstances shall the offering memorandum constitute an offer to sell or the solicitation of an offer to buy, nor shall there be any sale of these securities in any jurisdiction in which such offer, solicitation or sale would be unlawful. If a jurisdiction requires that the offering be made by a licensed broker or dealer and any initial purchaser of the notes offered under the offering memorandum or any affiliate of any such initial purchaser is a licensed broker or dealer in that jurisdiction, the offering shall be deemed to be made by such an initial purchaser or affiliate on behalf of the issuer in such jurisdiction.

The offering memorandum has not been approved by an authorized person in the United Kingdom for the purposes of section 21 of the Financial Services and Markets Act 2000 (the "FSMA"). The Notes may not be offered or sold other than to persons whose ordinary activities involve these persons in acquiring, holding, managing or disposing of investments (as principal or agent) for the purposes of their businesses or who it is reasonable to expect will acquire, hold, manage or dispose of investments (as principal or agent) for the purposes

of their businesses where the issue of the notes would otherwise constitute a contravention of section 19 of the FSMA by us. In addition, no person may communicate or cause to be communicated any invitation or inducement to engage in investment activity (within the meaning of section 21 of the FSMA) received by it in connection with the issue or sale of the notes other than in circumstances in which section 21(1) of the FSMA does not apply to us.

The offering memorandum has been sent to you in an electronic form. You are reminded that documents transmitted via this medium may be altered or changed during the process of electronic transmission and consequently none of the initial purchasers, any person who controls any joint lead manager, or any of their respective directors, officers, employees or agents accepts any liability or responsibility whatsoever in respect of any difference between the offering memorandum distributed to you in electronic format and the hard copy version available to you from the initial purchasers upon your request.

OFFERING MEMORANDUM

Strictly confidential

BRITISH AMERICAN TOBACCO

B.A.T Capital Corporation

(a corporation incorporated in the State of Delaware, United States of America)

$2,250,000,000 2.297% Notes due 2020
$2,250,000,000 2.764% Notes due 2022
$2,500,000,000 3.222% Notes due 2024
$3,500,000,000 3.557% Notes due 2027
$2,500,000,000 4.390% Notes due 2037
$2,500,000,000 4.540% Notes due 2047
$1,000,000,000 Floating Rate Notes due 2020
$750,000,000 Floating Rate Notes due 2022

Fully and Unconditionally Guaranteed by
British American Tobacco p.l.c., British American Tobacco Holdings (The Netherlands) B.V., B.A.T. Netherlands Finance B.V., B.A.T. International Finance p.l.c. and Reynolds American Inc.

B.A.T Capital Corporation, a corporation incorporated in the State of Delaware, United States of America, with file no. 911777 ("BATCAP" or the "Issuer") is offering $2,250,000,000 principal amount of its 2.297% Notes due 2020 (the "2020 Fixed Rate Notes"), $2,250,000,000 principal amount of its 2.764% Notes due 2022 (the "2022 Fixed Rate Notes"), $2,500,000,000 principal amount of its 3.222% Notes due 2024 (the "2024 Fixed Rate Notes"), $3,500,000,000 principal amount of its 3.557% Notes due 2027 (the "2027 Fixed Rate Notes"), $2,500,000,000 principal amount of its 4.390% Notes due 2037 (the "2037 Fixed Rate Notes"), $2,500,000,000 principal amount of its 4.540% Notes due 2047 (the "2047 Fixed Rate Notes", and together with the 2020 Fixed Rate Notes, the 2022 Fixed Rate Notes, the 2024 Fixed Rate Notes, the 2027 Fixed Rate Notes and the 2037 Fixed Rate Notes, the "Fixed Rate Notes"), $1,000,000,000 principal amount of its floating rate notes due 2020 (the "2020 Floating Rate Notes") and $750,000,000 principal amount of its floating rate notes due 2022 (the "2022 Floating Rate Notes", and together with the 2020 Floating Rate Notes, the "Floating Rate Notes"). Together, the Fixed Rate Notes and the Floating Rate Notes are referred to as the "Notes". In this Offering Memorandum, we refer to each series of the Fixed Rate Notes and Floating Rate Notes as a "series" of Notes. The Notes will be fully and unconditionally guaranteed by British American Tobacco p.l.c. ("BAT" or the "Parent Guarantor"), a public limited liability company incorporated in England and Wales with registration no. 03407696 and registered as an external company in the Republic of South Africa with the registration number 2008/023963/10, B.A.T. International Finance p.l.c., a public limited liability company incorporated in England and Wales with registration no. 1060930 ("BATIF"), British American Tobacco Holdings (The Netherlands) B.V. ("BATHTN"), a private company with limited liability (*besloten vennootschap met beperkte aansprakelijkheid*) incorporated under the laws of The Netherlands and registered with the Trade Register (*Handelsregister*) of the Chamber of Commerce of Amsterdam under registration no. 33236251, B.A.T. Netherlands Finance B.V. ("BATNF"), a private company with limited liability (*besloten vennootschap met beperkte aansprakelijkheid*) incorporated under the laws of The Netherlands and registered with the Trade Register (*Handelsregister*) of the Chamber of Commerce of Amsterdam under registration no. 60533536 (together with BATHTN, the "Dutch Guarantors") and Reynolds American Inc. ("RAI"), a company incorporated in the State of North Carolina, United States of America, with North Carolina Secretary of State identification no. 0705047 (the "Guarantees"). As described in "*Description of the Notes and the Guarantees*", any Subsidiary Guarantor of the Notes (including RAI) other than BATIF or the Dutch Guarantors will be automatically released from all obligations under its Guarantee under certain circumstances. The entities providing a Guarantee are referred to as "Guarantors".

Interest on the Notes will accrue from the original issue date of the Notes. Interest on the 2020 Fixed Rate Notes will be payable semi-annually in arrear on February 14 and August 14 of each year, commencing on February 14, 2018. Interest on the 2022 Fixed Rate Notes, the 2024 Fixed Rate Notes, the 2027 Fixed Rate Notes, the 2037 Fixed Rate Notes and the 2047 Fixed Rate Notes will be payable semi-annually in arrear on February 15 and August 15 of each year, commencing on February 15, 2018. Interest on the 2020 Floating Rate Notes will be payable quarterly in arrear on February 14, May 14, August 14 and November 14 of each year, commencing on November 14, 2017. Interest on the 2022 Floating Rate Notes will be payable quarterly in arrear on February 15, May 15, August 15 and November 15 of each year, commencing on November 15, 2017. The 2020 Fixed Rate Notes, the 2022 Fixed Rate Notes, 2024 Fixed Rate Notes, 2027 Fixed Rate Notes, 2037 Fixed Rate Notes and the 2047 Fixed Rate Notes will mature on August 14, 2020, August 15, 2022, August 15, 2024, August 15, 2027, August 15, 2037 and August 15, 2047, respectively and the 2020 Floating Rate Notes and 2022 Floating Rate Notes will mature on August 14, 2020 and August 15, 2022, respectively (in each case, a "Maturity Date"), and upon surrender on the relevant Maturity Date will be repaid at 100% of the principal amount thereof together with any unpaid and accrued interest.

The Fixed Rate Notes are redeemable prior to their relevant Maturity Dates, in whole or in part, at the option of the Issuer at a redemption price calculated as set forth under "*Description of the Notes and the Guarantees*". For series of Notes having a maturity date at least five years from the issue date, on or after the applicable Par Call Date (as defined in "*Description of the Notes and the Guarantees — Redemption — Optional Redemption*"), if any, the Issuer may redeem the relevant series of Notes, in whole or in part, at its option, at a redemption price equal to 100% of the principal amount of the Notes of such series to be redeemed, plus accrued and unpaid interest on the principal amount being redeemed to, but not including, the redemption date.

The Notes will be issued in registered form in denominations of $2,000 and integral multiples of $1,000 in excess thereof. The Notes will be represented by Global Notes (as defined herein) registered in the name of a nominee of The Depository Trust Company ("DTC"). Beneficial interests in Global Notes (as defined herein) will be shown on, and transfers thereof will be effected only through, records maintained by DTC and its participants. Except as described herein, Notes in definitive form will not be issued. See "*Description of the Notes and the Guarantees*".

The Notes and the Guarantees will be direct, unsecured and unsubordinated obligations of the Issuer and the Guarantors, respectively, and will rank *pari passu* with all other direct, unsecured and unsubordinated obligations (except those obligations preferred by statute or operation of law) of the Issuer and the Guarantors, respectively, from time to time outstanding. Application has been made to the Financial Conduct Authority in its capacity as competent authority under the Financial Services and Markets Act 2000 (the "UK Listing Authority") for each series of Notes to be admitted to the Official List of the UK Listing Authority (the "Official List") and to the London Stock Exchange plc (the "London Stock Exchange") for each series of Notes to be admitted to trading on the London Stock Exchange's Professional Securities Market (the "PSM"). References in this Offering Memorandum to the Notes being "listed" (and all related references) shall mean that the Notes have been admitted to the Official List and have been admitted to trading on the PSM. The PSM is not a regulated market for the purposes of Directive 2004/39/EC of the European Parliament and of the Council on markets in financial instruments.

This investment involves risk. See "*Risk Factors*" beginning on page 38.

The Notes and the Guarantees have not been registered under the United States Securities Act of 1933, as amended (the "Securities Act"), or any state securities laws and are being offered and sold within the United States only to "qualified institutional buyers" ("QIBs"), as defined in Rule 144A under the Securities Act ("Rule 144A"), and to persons who are not U.S. persons and are located outside the United States in reliance on Regulation S under the Securities Act ("Regulation S"). Prospective purchasers are hereby notified that the seller of any Note may be relying on the exemption from provisions of Section 5 of the Securities Act provided by Rule 144A thereunder. For a description of certain restrictions on transfers of the Notes, see "*Plan of Distribution*" and "*Notice to Investors*".

We will agree to file a registration statement with the SEC relating to an offer to exchange the Notes for publicly traded notes having substantially identical terms. For further details, see "*Registration Rights Agreement*".

Price for 2020 Fixed Rate Notes: 100% plus accrued interest, if any, from August 15, 2017
Price for 2022 Fixed Rate Notes: 100% plus accrued interest, if any, from August 15, 2017
Price for 2024 Fixed Rate Notes: 100% plus accrued interest, if any, from August 15, 2017
Price for 2027 Fixed Rate Notes: 100% plus accrued interest, if any, from August 15, 2017
Price for 2037 Fixed Rate Notes: 100% plus accrued interest, if any, from August 15, 2017
Price for 2047 Fixed Rate Notes: 100% plus accrued interest, if any, from August 15, 2017
Price for 2020 Floating Rate Notes: 100% plus accrued interest, if any, from August 15, 2017
Price for 2022 Floating Rate Notes: 100% plus accrued interest, if any, from August 15, 2017

The Notes are offered subject to receipt and acceptance by the initial purchasers listed in the section of this Offering Memorandum entitled "*Plan of Distribution*" (the "Initial Purchasers"), to prior sale and to the Initial Purchasers' right to reject any order in whole or in part and to withdraw, cancel or modify the offer without notice. It is expected that delivery of beneficial interests in the Notes will be made through the facilities of DTC and its participants, including Euroclear Bank, S.A./N.V. as operator of the Euroclear System ("Euroclear"), and Clearstream Banking, *société anonyme*, Luxembourg ("Clearstream, Luxembourg"), on or about August 15, 2017, against payment therefor in immediately available funds.

Joint Book-Running Managers

BofA Merrill Lynch **Barclays** **Citigroup** **Deutsche Bank Securities** **HSBC**

Bookrunners

Mizuho Securities **NatWest Markets** **Santander** **SMBC Nikko** **Société Générale Corporate & Investment Banking**

Co-Managers

Bank of China **BBVA** **COMMERZBANK** **ING** **Lloyds Securities** **Scotiabank** **Standard Chartered Bank** **UniCredit Bank**

The date of this Offering Memorandum is August 9, 2017.

IMPORTANT: You must read the following before continuing. The following applies to this Offering Memorandum. You are therefore advised to read this carefully before reading, accessing or making any other use of this Offering Memorandum. In accessing this Offering Memorandum, you agree to be bound by the following terms and conditions, including any modifications to them any time you receive any information.

This Offering Memorandum does not constitute an offer of any securities other than those to which it relates or an offer to sell, or solicitation of an offer to buy, to any person in any jurisdiction where such an offer or solicitation would be unlawful. This Offering Memorandum comprises listing particulars given in compliance with the listing rules made under section 73A of the Financial Services and Markets Act 2000 (the "FSMA") by the UK Listing Authority for the purpose of giving information with regard to us and the Notes in connection with the application for admission of the Notes to the Official List and to trading on the PSM.

Neither the Notes nor the Guarantees have been registered with, or recommended or approved by, the U.S. Securities and Exchange Commission (the "Commission") or any other federal or state securities commission or regulatory authority, nor has the Commission or any such other commission or regulatory authority passed upon the accuracy or adequacy of this Offering Memorandum. Any representation to the contrary is a criminal offense.

NOTICE TO INVESTORS IN THE EUROPEAN ECONOMIC AREA

This Offering Memorandum has been prepared on the basis that any offer of the Notes in any Member State of the European Economic Area (the "EEA") which has implemented the Prospectus Directive (each, a "Relevant Member State") will be made pursuant to an exemption under the Prospectus Directive from the requirement to publish a prospectus for offers of securities. Accordingly, any person making or intending to make any offer in that Relevant Member State of Notes which are the subject of the offering contemplated in this Offering Memorandum may only do so in circumstances in which no obligation arises for the Issuer, the Guarantors or the Initial Purchasers to publish a prospectus pursuant to Article 3 of the Prospectus Directive, in each case, in relation to such offer. None of the Issuer, the Guarantors or the Initial Purchasers has authorized, nor do they authorize, the making of any offer of the Notes in circumstances in which an obligation arises for the Issuer, the Guarantors or the Initial Purchasers to publish a prospectus for such offer. The expression "Prospectus Directive" means Directive 2003/71/EC (as amended, including by Directive 2010/73/EU) and includes any relevant implementing measure in the Relevant Member State.

NOTICE TO INVESTORS IN THE UNITED KINGDOM

Each Initial Purchaser has represented and agreed that:

- it has only communicated or caused to be communicated and will only communicate or cause to be communicated an invitation or inducement to engage in investment activity (within the meaning of section 21 of the FSMA) received by it in connection with the issue or sale of any Notes in circumstances in which section 21(1) of the FSMA does not apply to the Issuer or the Guarantors; and
- it has complied and will comply with all applicable provisions of the FSMA with respect to anything done by it in relation to any Notes in, from or otherwise involving the United Kingdom.

NOTICE TO INVESTORS IN JAPAN

The Notes have not been and will not be registered under the Securities and Exchange Law of Japan and are not being offered or sold and may not be offered or sold, directly or indirectly, in Japan or to or for the account of any resident of Japan, except (i) pursuant to an exemption from the registration requirements of the Securities and Exchange Law of Japan and (ii) in compliance with any other applicable requirements of Japanese law.

NOTICE TO INVESTORS IN HONG KONG

The contents of this Offering Memorandum have not been reviewed by any regulatory authority in Hong Kong. Persons who are invited to purchase or subscribe for the Notes or to whom this Offering Memorandum is sent are advised to exercise caution in relation to the offer. Persons who are in any doubt about any of the contents of this Offering Memorandum should obtain independent professional advice. No action has been taken to authorize the offer of the Notes to the public in Hong Kong. Accordingly, the Notes may not be offered or sold, or re-offered or resold, and this Offering Memorandum may not be issued, circulated or distributed, in Hong Kong nor may any other advertisement, invitation or document related to the Notes be issued in Hong Kong.

NOTICE TO INVESTORS IN CANADA

The Notes may be sold only to purchasers purchasing, or deemed to be purchasing, as principal that are accredited investors, as defined in National Instrument 45-106 Prospectus Exemptions or subsection 73.3(1) of the Securities Act (Ontario), and are permitted clients, as defined in National Instrument 31-103 Registration Requirements, Exemptions and Ongoing Registrant Obligations. Any resale of the Notes must be made in accordance with an exemption from, or in a transaction not subject to, the prospectus requirements of applicable securities laws.

Securities legislation in certain provinces or territories of Canada may provide a purchaser with remedies for rescission or damages if this Offering Memorandum (including any amendment thereto) contains a misrepresentation, provided that the remedies for rescission or damages are exercised by the purchaser within the time limit prescribed by the securities legislation of the purchaser's province or territory. The purchaser should refer to any applicable provisions of the securities legislation of the purchaser's province or territory for particulars of these rights or consult with a legal advisor.

Pursuant to section 3A.3 (or, in the case of securities issued or guaranteed by the government of a non-Canadian jurisdiction, section 3A.4) of National Instrument 33-105 Underwriting Conflicts (NI 33-105), the Initial Purchasers are not required to comply with the disclosure requirements of NI 33-105 regarding underwriter conflicts of interest in connection with this offering.

NOTICE TO INVESTORS IN THE NETHERLANDS

The Notes are not being offered or sold and may not be offered or sold, directly or indirectly, in The Netherlands, except if such offer or sale is made exclusively to persons who or legal entities which are qualified investors (*gekwalificeerde beleggers*) within the meaning of section 1:1 of the Financial Supervision Act (*Wet op het financieel toezicht*) of The Netherlands.

NOTICE TO INVESTORS IN SOUTH AFRICA

No action has been taken to authorize the offer of the Notes to the public in South Africa. Accordingly, the Notes may not be offered or sold, or re-offered or resold to the public in South Africa, and this Offering Memorandum may not be issued, circulated or distributed to the public in South Africa nor may any other advertisement, invitation or document related to the Notes be issued to the public in South Africa. Should a South African resident wish to participate in the offering, such participation would be subject to South African exchange control regulations.

IMPORTANT NOTICE

THIS OFFERING IS AVAILABLE ONLY TO INVESTORS WHO EITHER (1) ARE QIBs UNDER RULE 144A OR (2) ARE NOT U.S. PERSONS AND ARE LOCATED OUTSIDE OF THE UNITED STATES IN ACCORDANCE WITH REGULATION S.

This Offering Memorandum is being provided on a confidential basis to QIBs in the United States and to persons who are not U.S. persons and are located outside the United States for use solely in connection with the offering of the Notes. Its use for any other purpose is not authorized. This Offering Memorandum may not be copied or reproduced in whole or in part, nor may it be distributed or any of its contents be disclosed to any person other than the prospective investors to whom it is being provided.

Prospective investors should note that there are further restrictions on the offering and sale of the Notes and the distribution of this Offering Memorandum. See "*Plan of Distribution*" and "*Notice to Investors*".

No dealer, salesperson or other person has been authorized to give any information or to make any representation not contained in this Offering Memorandum and, if given or made, such information or representation must not be relied upon as having been authorized by the Issuer, the Guarantors, any of their respective affiliates or the Initial Purchasers. None of the Issuer, the Guarantors or the Initial Purchasers takes responsibility for, or provides any assurance as to the reliability of, any information that others may give you. Neither the delivery of this Offering Memorandum nor any sale made under it shall, under any circumstances, create any implication that there has been no change in the affairs of the Issuer or any of the Guarantors since the date of this Offering Memorandum or that the information contained in this Offering Memorandum is correct as of any time subsequent to that date.

By receiving this Offering Memorandum, investors acknowledge that they have had an opportunity to request for review, and have received, all additional information they deem necessary to verify the accuracy and completeness of the information contained in this Offering Memorandum. See "*Available Information and Reports to Noteholders*".

Investors also acknowledge that they have not relied on the Initial Purchasers in connection with their investigation of the accuracy of this information or their decision on whether to invest in the Notes. The contents of this Offering Memorandum are not to be considered as legal, business or tax advice. Prospective investors should consult their own counsel, accountants and other advisers as to legal, tax, business, financial and related aspects of a purchase of the Notes.

In making an investment decision, investors must rely on their own examination of the Issuer, the Guarantors and their respective affiliates, the terms of the offering of the Notes and the merits and risks involved. This offering is being made in reliance upon exemptions from registration under the Securities Act for an offer and sale of securities that does not involve a public offering. By purchasing the Notes, investors are deemed to have made the acknowledgements, representations, warranties and agreements set forth under "*Notice to Investors*".

Each potential investor in the Notes must determine the suitability of that investment in light of their own circumstances. In particular, each potential investor should:

- have sufficient knowledge and experience to make a meaningful evaluation of the merits and risks of investing in the Notes;
- have access to, and knowledge of, appropriate analytical tools to evaluate, in the context of their particular financial situation, an investment in the Notes and the impact such investment will have on their overall investment portfolio;
- have sufficient financial resources and liquidity to bear all of the risks of an investment in the Notes, including where principal or interest is payable in one or more currencies, or where the currency for principal or interest payments is different from the potential investor's currency;
- understand thoroughly the terms of the Notes and be familiar with the behavior of any relevant indices and financial markets; and
- be able to evaluate (either alone or with the help of a financial adviser) possible scenarios for economic, interest rate and other factors that may affect their investment and their ability to bear the applicable risks.

Potential investors should not invest in the Notes unless they have the expertise (either alone or with the help of a financial adviser) to evaluate how the Notes will perform under changing conditions, the resulting effects on the value of such Notes and the impact this investment will have on the potential investor's overall investment portfolio. The investment activities of certain investors are subject to investment laws and regulations, or review or regulation by certain authorities and each potential investor should consult their legal advisers or the appropriate regulators.

The Initial Purchasers reserve the right to withdraw this offering of Notes at any time and to reject any commitment to subscribe for the Notes, in whole or in part. The Initial Purchasers also reserve the right to allot less than the full amount of Notes sought by investors. The Initial Purchasers and certain related entities may acquire a portion of the Notes for their own account.

No action has been taken by the Initial Purchasers, the Issuer, the Guarantors or any other person that would permit an offering of the Notes or the circulation or distribution of this Offering Memorandum or any offering material in relation to the Issuer, the Guarantors or their respective affiliates or the Notes in any country or jurisdiction where action for that purpose is required.

The laws of certain jurisdictions may restrict the distribution of this Offering Memorandum and the offer and sale of the Notes. Persons into whose possession this Offering Memorandum or any of the Notes come must inform themselves about, and observe any such restrictions. None of the Issuer, the Guarantors, the Initial Purchasers or their respective representatives is making any representation to any offeree or any purchaser of the Notes regarding the legality of any investment in the Notes by such offeree or any purchaser under applicable legal investment or similar laws or regulations. Accordingly, no Notes may be offered or sold, directly or indirectly, and neither this Offering Memorandum nor any advertisement or other offering material may be distributed or published in any jurisdiction, except under circumstances that will result in compliance with any applicable laws and regulations. Persons into whose possession this Offering Memorandum or any Notes may come must inform themselves about, and observe any such restrictions on the distribution of this Offering

Memorandum and the offering and sale of the Notes. In particular, there are restrictions on the distribution of this Offering Memorandum and the offer or sale of the Notes in the United States, the EEA, including the United Kingdom and The Netherlands, Canada, Japan, Hong Kong and South Africa. For a further description of certain restrictions on the offering and sale of the Notes and the distribution of the Offering Memorandum, see "*Plan of Distribution*" and "*Notice to Investors*".

The Notes will be issued in fully registered form and only in denominations of $2,000 and integral multiples of $1,000 in excess thereof. The Notes will be issued initially in fully registered form as beneficial interests in the Global Notes (defined below). QIBs may elect to hold the Global Notes (the "Rule 144A Global Notes") purchased by them through the facilities of DTC, which will act as depositary for the Notes. Holders of Notes sold in offshore transactions in reliance on Regulation S under the Securities Act may elect to hold the Global Notes (the "Regulations S Global Notes" and, together with the Rule 144A Global Notes, the "Global Notes") through the facilities of Euroclear and Clearstream, Luxembourg as participants in DTC. Prior to the date that is 40 days after the later of the commencement of the offering or the closing date, beneficial interests in such Regulation S Global Notes may be held only through Euroclear and Clearstream, Luxembourg. See "*Book Entry, Delivery and Form*".

To purchase the Notes, investors must comply with all applicable laws and regulations in force in any jurisdiction in which investors purchase, offer or sell the Notes or possess or distribute this Offering Memorandum. Investors must also obtain any consent, approval or permission required by such jurisdiction for investors to purchase, offer or sell any of the Notes under the laws and regulations in force in any jurisdiction in which investors are subject or in which investors make such purchase, offer or sale. None of the Issuer, the Guarantors, their respective affiliates or the Initial Purchasers will have responsibility therefor.

Each of the Issuer and the Guarantors accepts responsibility for the information contained in this Offering Memorandum. To the best of the knowledge and belief of the Issuer and the Guarantors (having taken all reasonable care to ensure that such is the case), the information contained in this Offering Memorandum is in accordance with the facts and does not omit anything likely to affect the import of such information.

IN CONNECTION WITH THIS ISSUE, MERRILL LYNCH, PIERCE, FENNER & SMITH INCORPORATED, BARCLAYS CAPITAL INC., CITIGROUP GLOBAL MARKETS INC., DEUTSCHE BANK SECURITIES INC. AND HSBC SECURITIES (USA) INC., AS STABILIZING MANAGERS (OR ANY PERSON ACTING ON BEHALF OF ANY STABILIZING MANAGER), MAY OVER-ALLOT THE NOTES (PROVIDED THAT THE AGGREGATE PRINCIPAL AMOUNT OF THE NOTES ALLOTTED DOES NOT EXCEED 105 PER CENT OF THE AGGREGATE NOMINAL AMOUNT OF THE NOTES) OR EFFECT TRANSACTIONS WITH A VIEW TO SUPPORTING THE MARKET PRICE OF THE NOTES AT A LEVEL HIGHER THAN THAT WHICH MIGHT OTHERWISE PREVAIL. HOWEVER, STABILIZATION MAY NOT NECESSARILY OCCUR. ANY STABILIZATION ACTION MAY BEGIN ON OR AFTER THE DATE ON WHICH ADEQUATE PUBLIC DISCLOSURE OF THE TERMS OF THE OFFER OF THE NOTES IS MADE AND, IF BEGUN, MAY CEASE AT ANY TIME, BUT IT MUST END NO LATER THAN THE EARLIER OF 30 DAYS AFTER THE ISSUE DATE OF THE NOTES AND 60 DAYS AFTER THE DATE OF THE ALLOTMENT OF THE RELEVANT NOTES. SEE "*PLAN OF DISTRIBUTION*". ANY STABILIZATION ACTION OR OVER-ALLOTMENT MUST BE CONDUCTED BY THE RELEVANT STABILIZING MANAGER(S) (OR ANY PERSON ACTING ON BEHALF OF ANY STABILIZING MANAGER(S)) IN ACCORDANCE WITH ALL APPLICABLE LAWS AND RULES.

SERVICE OF PROCESS AND ENFORCEMENT OF CIVIL LIABILITIES

Each of BATIF and the Parent Guarantor is a public limited liability company incorporated under the laws of England and Wales. Each of the Dutch Guarantors is a private company with limited liability incorporated in The Netherlands. All respective directors and executive officers of BATIF and the Dutch Guarantors and most of the directors and executive officers of the Parent Guarantor are resident outside of the United States and a substantial portion of their assets are located outside of the United States. Only BATCAP and RAI are companies incorporated in a state of the United States. Although BATIF and each of the non-U.S. Guarantors has agreed, in accordance with the terms of the indenture governing the Notes (the "Indenture"), to accept service of process in the United States by agents designated for such purpose, it may not be possible for holders of the Notes (a) to effect service of process upon BATIF, the non-U.S. Guarantors or their respective directors or officers or (b) to enforce judgments of courts of the United States predicated upon the civil liability of such entities or persons under the U.S. securities laws against any such entities or persons in the courts of a foreign jurisdiction. We have been advised by our English legal counsel, Linklaters LLP, and our Dutch legal counsel, Stibbe N.V., that there is doubt as to the direct enforceability in England and The Netherlands, respectively, of civil liabilities predicated upon the federal securities laws of the United States. A judgment which is enforceable by execution in the United

States and has been obtained in a U.S. court will not be enforceable in The Netherlands without re-litigation in the absence of a treaty between The Netherlands and the United States with respect to the mutual recognition and enforcement of civil judgments, and no such treaty currently exists between The Netherlands and the United States. In order to obtain a judgment enforceable in The Netherlands, claimants must litigate the relevant claim again before a Dutch court of competent jurisdiction. Under current practice, the courts of The Netherlands may be expected to render a judgment in accordance with the judgment of the relevant U.S. court, provided that such judgment (i) is a final judgment and has been rendered by a court which has established its jurisdiction vis-à-vis the relevant Dutch Guarantor on the basis of internationally accepted grounds of jurisdiction, (ii) has not been rendered in violation of elementary principles of fair trial, (iii) is not contrary to the public policy of The Netherlands, and (iv) is not incompatible with (a) a prior judgment of a Dutch court rendered in a dispute between the same parties, or (b) a prior judgment of a foreign court rendered in a dispute between the same parties, concerning the same subject matter and based on the same cause of action, provided that such prior judgment is capable of being recognized in The Netherlands; counsel reserves opinion as to whether this practice extends to default judgments.

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AVAILABLE INFORMATION AND REPORTS TO NOTEHOLDERS

As of the date of this Offering Memorandum, BAT is subject to the periodic reporting requirements of the Exchange Act and furnishes reports to the SEC on Form 6-K. Beginning in 2018, in respect of the year ending December 31, 2017, BAT will file annual reports with the SEC on Form 20-F. You may read and copy any document BAT files at the SEC's public reference room at 100 F Street, N.E., Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information on the operation of the public reference room. In addition, the SEC maintains an internet site at http://www.sec.gov that contains information regarding issuers that file electronically with the SEC.

Copies of BAT's Annual Report (as defined below), the contents of which are not part of, and are not incorporated by reference into, this Offering Memorandum, may be obtained at no cost by written or oral request to the Company Secretary, British American Tobacco p.l.c., Globe House, 4 Temple Place, London WC2R 2PG, United Kingdom, +44 (0) 207 845 1000.

Each of the Issuer and the Guarantors has agreed that it will make available, upon request, to any holder or prospective purchaser of the Notes the information required pursuant to Rule 144A(d)(4) under the Securities Act with respect to itself, during any period in which neither the Issuer nor the Guarantors of such Notes are subject to the reporting requirements of Sections 13 or 15(d) of the Exchange Act or exempt by virtue of Rule 12g3-2(b) thereunder. Any such requests should be directed to the Parent Guarantor care of the Company Secretary at British American Tobacco p.l.c., Globe House, 4 Temple Place, London WC2R 2PG, United Kingdom.

In accordance with its obligations under the Disclosure Rules and Transparency Rules made under sections 73A and 89A of the FSMA by the UK Listing Authority, BAT currently publishes the following financial information:

Annual Report and Accounts ("Annual Report"). This includes the consolidated, audited accounts for the financial year for BAT, typically published in March.

Half-Yearly Report. This includes the consolidated, unaudited accounts for the first six months of the financial year for BAT, typically published in July.

CERTAIN DEFINITIONS

Unless otherwise indicated or as the context otherwise requires, all references in this Offering Memorandum to:

- "acquisition facility" refer to the term loan facilities agreement, dated as of January 16, 2017, among B.A.T. International Finance p.l.c. and B.A.T Capital Corporation, as original borrowers, BAT, as guarantor, HSBC Bank plc, as agent, HSBC Bank USA, National Association, as U.S. agent and the lenders and financial institutions party thereto, providing for unsecured and unsubordinated term loan facilities in an aggregate principal amount of up to $25.0 billion, $25.0 billion of which was drawn on July 24, 2017 for the purpose of financing the merger and paying related taxes, fees, costs and expenses. A portion of the amounts outstanding under the acquisition facility will be repaid with the proceeds from the offering of the Notes. See "*Use of Proceeds*" and "*Capitalization and Indebtedness*";
- "American Snuff" refer to the American Snuff segment of RAI, prior to completion of the merger;
- "American Snuff Company" refer to American Snuff Company, LLC;
- "ANPRM" refer to the Advance Notices of Proposed Rulemaking the FDA issues to seek comments from the public on proposed regulations;
- "B&W" refer to Brown & Williamson Holdings, Inc., f/k/a Brown & Williamson Tobacco Corporation, a Delaware corporation and indirect, wholly owned subsidiary of BAT;
- "B&W business combination" refer to the combination of the U.S. assets, liabilities and operations, other than certain specified assets and liabilities, of BAT's wholly owned subsidiary, B&W, with RJR Tobacco Company in July 2004;
- "BAT" refer to British American Tobacco p.l.c.;
- "BAT ADSs" refer to BAT's American depositary shares, each of which represents one BAT ordinary share and may be evidenced by American depositary receipts;
- "BAT ADS ratio change" refer to the change from each BAT ADS representing two BAT ordinary shares to each BAT ADS representing one BAT ordinary share as of February 14, 2017;
- "BAT board of directors" refer to the board of directors of BAT, as described in "*Management*";
- "BAT Group" refer collectively to BAT and its subsidiaries, including, since completion of the merger, RAI and its subsidiaries;
- "BAT Group management board" refer to the members of the management board of the BAT Group, as described in "*Management*";
- "BAT ordinary shares" refer to ordinary shares, nominal value 25 pence per share, of BAT;
- "cash-out RSU" refer to each RAI RSU and each RAI performance share, in each case, that was granted prior to the date of the merger agreement, other than RAI retention RSUs;
- "Code" refer to the U.S. Internal Revenue Code of 1986, as amended;
- "CNTC" refer to China National Tobacco Corporation;
- "CTBAT" refer to CTBAT International Co. Ltd;
- "DSBS" refer to the British American Tobacco p.l.c. Deferred Annual Share Bonus Scheme;
- "EURIBOR" refer to Euro Interbank Offered Rate;
- "Exchange Act" refer to the U.S. Securities Exchange Act of 1934, as amended;
- "Exchange Offer" refer to the offer registered under a registration statement to be filed with the SEC by the Issuer to exchange its Notes for publicly traded and registered notes having substantially identical terms pursuant to a registration rights agreement to be entered into by the Issuer as part of this offering;
- "excluded holders" refer to holders of shares of RAI common stock who did not vote, or cause or permit to be voted, any shares of RAI common stock in favor of the approval of the merger agreement at the special meeting of RAI in connection with the merger and who properly asserted (and did not lose or effectively withdraw) their rights of appraisal in accordance with Article 13 of the North Carolina Business Corporation Act (however, in the case of the RAI 401k Savings Plan and the Puerto Rico Savings & Investment Plan sponsored by RAI, the trustee of the RAI 401k Savings Plan and the

custodian of the Puerto Rico Savings & Investment Plan sponsored by RAI were treated as excluded holders with respect to shares of RAI common stock as to which such trustee or custodian exercised appraisal rights even though such trustee or custodian may have voted other shares in the applicable plan in favor of approval of the merger agreement);

- "FII GLO" refer to Franked Investment Income Group Litigation Order;
- "FDA" refer to the U.S. Food and Drug Administration;
- "FDA Tobacco Act" refer to Family Smoking Prevention and Tobacco Control Act of 2009, as amended;
- "global drive brands" or "GDBs" refer to Dunhill, Kent, Lucky Strike, Pall Mall and Rothmans, collectively;
- "Governance Agreement" refer to the governance agreement, dated as of July 30, 2004, as amended, entered into by RAI, B&W and BAT in connection with the B&W business combination;
- "HSR Act" refer to Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended;
- "HM Revenue & Customs" refer to Her Majesty's Revenue and Customs of the United Kingdom;
- "IFRS" refer to International Financial Reporting Standards as adopted by the European Union;
- "JSE" refer to Johannesburg Stock Exchange;
- "JTI" refer to Japan Tobacco Inc.;
- "JTI Holding" refer to JT International Holding BV, a subsidiary of Japan Tobacco Inc.;
- "key markets" refer to Americas, Western Europe, Eastern Europe, Middle East, Asia and Asia-Pacific;
- "LIBOR" refer to London Interbank Offered Rate;
- "Lorillard" refer to Lorillard, LLC, a Delaware limited liability company and a wholly owned subsidiary of RAI, f/k/a Lorillard, Inc., a Delaware corporation;
- "Lorillard Divestiture" refer to the acquisition by a wholly owned subsidiary, n/k/a ITG Brands, LLC, of Imperial Brands, PLC, f/k/a Imperial Tobacco Group, PLC, on June 12, 2015, of certain assets (1) owned by certain RAI subsidiaries or affiliates relating to the cigarette brands Winston, Kool and Salem, and (2) owned by certain Lorillard subsidiaries or affiliates relating to the cigarette brand Maverick and the "e-vapor" brand blu (including Skycig), as well as Lorillard's owned and leased real property, and certain transferred employees, together with associated liabilities;
- "Lorillard merger" refer to the acquisition by RAI of Lorillard on June 12, 2015, in a cash and stock transaction;
- "Lorillard Tobacco" refer to Lorillard Tobacco Company LLC, f/k/a Lorillard Tobacco Company, a wholly owned subsidiary of Lorillard at the time of the Lorillard merger;
- "Louisville" refer to Louisville Securities Limited, a private limited company incorporated under the laws of England and Wales and an indirect, wholly owned subsidiary of BAT;
- "LSE" refer to London Stock Exchange plc;
- "LTIP" refer to the applicable BAT Long-Term Incentive Plan;
- "merger" refer to the merger of Merger Sub with and into RAI; see "*The Merger*";
- "merger agreement" refer to the Agreement and Plan of Merger, dated as of January 16, 2017, as it and the plan of merger contained therein were amended as of June 8, 2017, among BAT, BATUS Holdings Inc., RAI and Merger Sub;
- "merger consideration" refer to the consideration, per share of RAI common stock, received in the merger by RAI shareholders (other than the BAT Group and excluded holders), consisting of: a number of BAT ADSs representing 0.5260 of a BAT ordinary share (the "stock portion of the merger consideration"), plus $29.44 in cash, without interest (the "cash portion of the merger consideration");
- "Merger Sub" refer to Flight Acquisition Corporation, a North Carolina corporation and an indirect, wholly owned subsidiary of BAT, which, pursuant to the merger agreement, was merged with and into RAI with RAI as the surviving entity as an indirect, wholly owned subsidiary of BAT;
- "MSA" refer to the Master Settlement Agreement, dated as of November 23, 1998, among 46 U.S. states, the District of Columbia and five U.S. territories listed on the signature pages thereto, Philip

Morris Incorporated, RJR Tobacco Company, B&W, Lorillard Tobacco and various subsequent participating manufacturers listed on the National Association of Attorneys General's list of "Participating Manufacturers", as amended, supplemented or replaced;

- "MTM Adjustment" refer to a mark-to-market adjustment;
- "next generation products" refer to any tobacco or nicotine product developed to offer adult tobacco consumers potentially less risky alternatives to smoking conventional cigarettes and include (1) vapor products (such as e-cigarettes), which are battery powered electronic devices which heat a solution to create a vapor which can be inhaled, and (2) tobacco heating products, which are battery powered electronic devices that operate with specifically designed consumables containing tobacco, to deliver a real tobacco taste and aroma, and, in relation to RAI, also refer to (a) any device that employs a chemical reaction or combustible, carbonaceous fuel source for heat generation to produce an aerosol from a physically separate source and (b) products that contain nicotine for therapeutic purposes (such as products characterized as gums, lozenges and inhalers that are intended to be nicotine replacement therapy, referred to as NRT, products, and products characterized as devices that are intended to be used for NRT purposes);
- "Noteholder" refer to a "registered holder" of Notes;
- "NPM Adjustment" refer to the availability of a downward adjustment to the annual MSA settlement payment obligation for the calendar year ended December 31, 2003 related to arbitration between (a) RJR Tobacco Company, SFNTC and certain other participating manufacturers and (b) certain settling states under the MSA;
- "NYSE" refer to the New York Stock Exchange;
- "NYSE MKT" refer to the NYSE MKT;
- "Parent Guarantor" refer to British American Tobacco p.l.c.;
- "Prospectus Directive" refer to Directive 2003/71/EC (as amended, including by Directive 2010/73/EU) and include any relevant implementing measure in the relevant member state;
- "Prospectus Directive Regulation" refer to Commission Regulation EC No. 809/2004, as amended from time to time;
- "RAI" refer to Reynolds American Inc., a North Carolina corporation;
- "RAI Group" refer collectively to RAI and its subsidiaries;
- "RAI-Lorillard merger agreement" refer to the Agreement and Plan of Merger, dated as of July 15, 2014, among Lorillard, RAI and Lantern Acquisition Co., a Delaware corporation and a wholly owned subsidiary of RAI;
- "RAI LTI" refer to former RAI equity awards that were assumed by BAT upon the completion of the merger, at which time they were converted into awards that, when earned, will be settled for BAT ADSs;
- "RAI Omnibus Plan" refer to the Reynolds American Inc. Amended and Restated 2009 Omnibus Incentive Compensation Plan;
- "RAI RSU" refer to any RAI restricted stock unit award subject solely to time-based vesting and not performance-based vesting (other than performance-based vesting only for purposes of Section 162(m) of the Code), payable in shares of RAI common stock;
- "RAI Share Repurchase Program" refer to an authorized repurchase, from time to time, on or before December 31, 2018, of up to $2 billion of outstanding shares of RAI common stock in open-market or privately negotiated transactions, in effect prior to the merger;
- "RJR Tobacco" refer to the RJR Tobacco segment of RAI, prior to completion of the merger;
- "RJR Tobacco Company" refer to R. J. Reynolds Tobacco Company, a North Carolina corporation and an indirect, wholly owned subsidiary of RAI;
- "RAI retention RSU" refer to three RAI RSU grants that were made prior to the date of the merger agreement that were assumed, and did not vest or settle upon the completion of the merger;
- "Registration Rights Agreement" refer to a registration rights agreement with respect to the Notes and the Guarantees to be entered into among BATCAP, the Guarantors and the Initial Purchasers;
- "Remuneration Policy" refer to the forward-looking remuneration policy for BAT directors and former directors, as approved at the 2016 annual general meeting of BAT;

- "Reynolds Defendants" refer to the defendants named in a number of tobacco-related legal actions, proceedings or claims seeking damages against RJR Tobacco Company, American Snuff Company, SFNTC, RJR Vapor, RAI, Lorillard and other RAI affiliates and indemnitees;
- "rollover RSU" refer to each RAI RSU or RAI performance share that, in either case, is not a cash-out RSU;
- "RSU exchange ratio" refer to the sum of (1) 0.5260 plus (2) the quotient of (a) $29.44 over (b) $69.25, the closing price of one BAT ADS on the last trading date preceding the completion date as reported on the NYSE MKT;
- "Santa Fe" refer to the Santa Fe segment of RAI, prior to completion of the merger;
- "SEC" refer to the U.S. Securities and Exchange Commission;
- "SFNTC" refer to Santa Fe Natural Tobacco Company, Inc.;
- "Sharesave Scheme" refer to the BAT Sharesave Scheme;
- "SIP" refer to the BAT Employee Share Ownership Plan;
- "SRS" refer to the BAT Share Reward Scheme;
- "State Settlement Agreements" refer to the MSA, together with settlement agreements with the states of Mississippi, Florida, Texas and Minnesota;
- "Term Sheet" refer to a binding term sheet entered into by certain signatory states and RJR Tobacco Company, Lorillard Tobacco, SFNTC and certain other participating manufacturers during the arbitration of the 2003 NPM Adjustment claim, that set forth terms to resolve NPM Adjustment claims for 2003 through 2012 as well as a restructured NPM Adjustment process to be applied to future volume years, starting with the 2013 volume year; and
- "tobacco litigation" refer to *United States v. Philip Morris, et al.*, No. 99-02496 (D.D.C.), and any other actions or judgments regarding any health or other impacts or alleged health or other impacts, including impacts cognizable under the Racketeer Influenced and Corrupt Organizations Act, from the development, manufacture, distribution, sale, advertising, marketing and/or use of any tobacco product (including products that are derived from tobacco, such as products containing tobacco-derived nicotine), including for the avoidance of doubt any and all actions or judgments regarding the presence of or exposure to smoke from any tobacco product.

Unless the context requires otherwise, "Group", "Company", "we", "us", or "our" refers to British American Tobacco p.l.c. and its subsidiaries on a consolidated basis, including, after completion of the merger on July 25, 2017, the RAI Group.

All brands, unless otherwise noted, referred to herein are trademarks owned or licensed by the BAT Group.

When used in describing aspects of the BAT Group's business, reference to "volume" is an unaudited operating measure and is calculated as the total global cigarette volume of the BAT Group's brands sold by its subsidiaries.

References in this Offering Memorandum to "2016", "2015", or similar refer to the given BAT or RAI, as applicable, financial year ended December 31.

References to "ton" refer to metric tonnes.

PRESENTATION OF FINANCIAL INFORMATION AND OTHER DATA

General

Unless otherwise indicated, financial information related to the BAT Group contained in this Offering Memorandum is prepared and presented in accordance with IFRS. Certain differences exist between IFRS and generally accepted accounting principles in the United States of America ("U.S. GAAP") which might be material to the financial information herein. The Indenture imposes no obligation on us to reconcile our future financial statements prepared under IFRS to U.S. GAAP. Accordingly, we have not prepared a reconciliation of our consolidated financial statements and related footnote disclosures between IFRS and U.S. GAAP. Potential investors should consult their own professional advisers for an understanding of the differences between IFRS and U.S. GAAP and how these differences might affect the financial information herein. All financial statements and financial information provided by or with respect to RAI and/or the RAI Group are prepared on the basis of U.S. GAAP and constitute RAI's primary financial statements or financial information. To the extent any financial information provided by or with respect to RAI and/or the RAI Group is prepared on a basis other than U.S. GAAP, such information is provided as an explanation of, or supplement to, RAI's and/or the RAI Group's primary U.S. GAAP based financial statements and information as reported on the face of RAI's and/or the RAI Group's U.S. GAAP financial statements.

This Offering Memorandum includes:

- the unaudited condensed consolidated interim financial statements of BAT as of June 30, 2017, and for the six months ended June 30, 2017 and 2016, prepared on the basis of IFRS (referred to in this Offering Memorandum as the BAT Group's unaudited condensed consolidated financial statements);
- the audited consolidated financial statements of BAT as of December 31, 2016, 2015 and 2014 and for each of the years in the three-year period ended December 31, 2016, prepared on the basis of IFRS (referred to in this Offering Memorandum as the BAT Group's consolidated financial statements);
- the unaudited condensed consolidated interim financial statements of RAI as of June 30, 2017 and for the three and six months ended June 30, 2017 and 2016, prepared on the basis of U.S. GAAP (referred to in this Offering Memorandum as the RAI Group's unaudited condensed consolidated financial statements);
- the audited consolidated financial statements of RAI as of December 31, 2016, 2015, and 2014 and for each of the years in the three-year periods ended December 31, 2016 and 2015, prepared on the basis of U.S. GAAP (referred to in this Offering Memorandum as the RAI Group's consolidated financial statements); and
- the audited financial statements of BATCAP as of December 31, 2016 and 2015 and for each of the years in the two-year period ended December 31, 2016, prepared in accordance with U.S. GAAP.

Unless indicated otherwise, financial data presented in this Offering Memorandum has been taken from the BAT Group's consolidated financial statements, the BAT Group's unaudited condensed consolidated financial statements, the RAI Group's consolidated financial statements and the RAI Group's unaudited condensed consolidated financial statements included in this Offering Memorandum.

BAT's financial statements for the year ended December 31, 2014, which were prepared in accordance with IFRS, were audited by PricewaterhouseCoopers LLP, referred to as PwC, in accordance with International Standards on Auditing (UK and Ireland). PwC issued its report on those statements on February 25, 2015. At the time its report was issued, PwC was independent under the Auditing Practices Board's Ethical Standards for Auditors. PwC is no longer independent under such standards. See "*Independent Auditors*".

For additional information on the presentation of financial information in this Offering Memorandum, see the BAT Group's consolidated financial statements, the BAT Group's unaudited condensed consolidated financial statements, the RAI Group's consolidated financial statements and the RAI Group's unaudited condensed consolidated financial statements included elsewhere in this Offering Memorandum.

Unaudited Pro Forma Financial Information relating to the merger

This Offering Memorandum includes the unaudited pro forma condensed combined financial information of BAT for the year ended December 31, 2016 and as of and for the six months ended June 30, 2017 after giving effect to the merger, excluding the offering of the Notes, referred to in this Offering Memorandum as Unaudited Pro Forma Financial Information. See "*BAT Unaudited Pro Forma Condensed Combined Financial Information*".

The Unaudited Pro Forma Financial Information, which has been produced for illustrative purposes only, by its nature addresses a hypothetical situation and, therefore, does not represent the BAT Group's actual financial

position or results. It is based on the available measures and certain assumptions and is not necessarily indicative of the results that would have been achieved if the merger had been completed on January 1, 2016 (in the case of the pro forma income statements) or June 30, 2017 (in the case of the pro forma balance sheet) or that may be achieved in the future, and is provided for informational purposes only.

The Unaudited Pro Forma Financial Information has been prepared in accordance with Annex II of the Prospectus Directive and not in accordance with the requirements of Regulation S-X under the Securities Act. In accordance with the Prospectus Directive Regulation, BAT has included certain non-recurring items related to the merger in its Pro Forma Income Statements, such as merger related transaction costs, which would not be included if the Pro Forma Income Statements were prepared in accordance with Regulation S-X under the Securities Act.

Investors should read the whole of this document, including the financial information included herein.

Rounding

The financial information set forth in this Offering Memorandum has been rounded for ease of presentation. Accordingly, in certain cases, the sum of the numbers in a column in a table may not conform to the total figure given for that column.

Non-IFRS Measures

In this Offering Memorandum, we present certain financial measures that are not recognized by IFRS or U.S. GAAP and which may not be permitted to appear on the face of the primary financial statements, or footnotes thereto. We believe that these additional measures, which are used internally, are useful to understand our underlying business performance.

Adjusted Profit from Operations

To supplement the BAT Group's results from operations presented in accordance with IFRS, the BAT Group management board, as the chief operating decision maker, reviews current and prior year adjusted profit from operations to evaluate the performance of the group and its geographic segments, to allocate resources to the overall business and to communicate financial performance to investors. Adjusted profit from operations is not a measure defined by IFRS. The BAT Group's most directly comparable IFRS measure to adjusted profit from operations is profit from operations. Adjusted profit from operations is defined as profit from operations before adjusting items in profit from operations. Adjusting items, as identified in accordance with the BAT Group's accounting policies, represent certain items of income and expense which the BAT Group considers distinctive based on their size, nature or incidence. In identifying and quantifying adjusting items, the BAT Group consistently applies a policy that defines criteria that are required to be met for an item to be classified as adjusting and provides details of items that are specifically excluded from being classified as adjusting items. Adjusting items in profit from operations include restructuring and integration costs, amortization of trademarks and similar intangibles, and a payment and release of a provision relating to non-tobacco litigation. The definition of adjusting items is explained within note 1 to the BAT Group's consolidated financial statements included in this Offering Memorandum.

The BAT Group management board believes that this additional measure is useful to investors, and is used by the BAT Group management board as described above, because it excludes the impact of adjusting items in profit from operations, which have less bearing on the routine operating activities of the BAT Group, thereby enhancing users' understanding of underlying business performance. The BAT Group management board also believes that adjusted profit from operations provides information that enables investors to better compare the BAT Group's business performance across periods.

Additionally, the BAT Group management board believes that similar measures are frequently used by securities analysts, investors and other interested parties in their evaluation of companies comparable to the BAT Group, many of which present an adjusted operating profit-related performance measure when reporting their results.

Adjusted profit from operations has limitations as an analytical tool. It is not a presentation made in accordance with IFRS, is not a measure of financial condition or liquidity and should not be considered as an alternative to profit for the year or profit from operations as determined in accordance with IFRS. Adjusted profit from operations is not necessarily comparable to similarly titled measures used by other companies. As a result, you should not consider this performance measure in isolation from, or as a substitute analysis for, the BAT Group's results of operations as determined in accordance with IFRS. See "*Summary Historical Consolidated Financial Data of BAT*" for additional information about adjusted profit from operations, as well as a reconciliation to profit from operations.

Results on a Constant Translational Currency Basis

Movements in foreign exchange rates have impacted the BAT Group's profit from operations. The BAT Group management reviews certain of its results, including revenue and adjusted profit from operations, at constant rates of exchange. The BAT Group calculates these financial measures at constant rates of exchange based on a retranslation, at prior year exchange rates, of the current year results of the BAT Group and its segments. The BAT Group does not adjust for the normal transactional gains and losses in operations that are generated by exchange movements. Although the BAT Group does not believe that these measures are a substitute for IFRS measures, the BAT Group does believe that such results excluding the impact of currency fluctuations year-on-year provide additional useful information to investors regarding the operating performance on a local currency basis. Accordingly, the constant rates of exchange financial measures appearing in the following discussion of the BAT Group results of operations should be read in conjunction with the information provided in note 2 Segmental Analyses to the BAT Group's consolidated financial statements included in this Offering Memorandum.

In the six months ended June 30, 2017 and 2016 and in 2016, 2015 and 2014, the BAT Group's results were affected by translational exchange rate movements. In the six months ended June 30, 2017 compared to six months ended June 30, 2016, at the prevailing exchange rates, revenue increased by 15.7%, profit from operations increased by 16.3% and adjusted profit from operations increased by 15.8%. At constant rates of exchange, revenue would have increased by 3.5%, profit from operations would have increased by 3.7% and adjusted profit from operations would have increased by 3.2%.

In 2016, at the prevailing exchange rates, revenue increased by 12.6%, profit from operations increased by 2.2% and adjusted profit from operations increased by 9.8% versus 2015. At constant rates of exchange, revenue would have increased by 6.9%, profit from operations would have decreased by 2.9% and adjusted profit from operations would have increased by 4.1%. This higher growth rate at prevailing exchange rates reflects the translational benefit as a result of the relative weakness of the pound sterling. In 2015, at the prevailing exchange rate, revenue decreased by 6.2%, profit from operations increased by 0.2% and adjusted profit from operations decreased by 7.6% versus 2014. At constant rates of exchange, revenue in 2015 would have increased by 5.4%, profit from operations would have increased by 13.6% and adjusted profit from operations would have increased by 4.0%. The lower growth rate at prevailing exchange rates reflects the devaluation of currencies, including in Russia, Nigeria, Ukraine, Venezuela and the eurozone.

Free Cash Flow

The BAT Group uses free cash flow to illustrate the cash flows before transactions relating to borrowings. Free cash flow is not a measure defined by IFRS. BAT defines free cash flow as net cash generated from operating activities adjusted for dividends paid to non-controlling interests, net interest paid, net capital expenditure (offset by sales of assets in the period) and proceeds from associates' share buy-backs. The most directly comparable IFRS measure to free cash flow is net cash generated from operating activities. The BAT Group management board believes that this additional measure, which is used internally, is useful to the users of the financial statements in helping them understand the underlying business performance and can provide insight into the cash flow available to, among other things, reduce debt and pay dividends. Free cash flow has limitations as an analytical tool. It is not a presentation made in accordance with IFRS and should not be considered as an alternative to net cash generated from operating activities determined in accordance with IFRS. Free cash flow is not necessarily comparable to similarly titled measures used by other companies. As a result, you should not consider this measure in isolation from, or as a substitute analysis for, the BAT Group's results of operations or cash flows as determined in accordance with IFRS. See *"Summary Historical Consolidated Financial Data of BAT"* for additional information about free cash flow, as well as a reconciliation to net cash generated from operating activities.

Net Debt

The BAT Group uses net debt to assess its financial capacity. Net debt is not a measure defined by IFRS. The most directly comparable IFRS measure to net debt is total borrowings. The BAT Group defines net debt as total borrowings, including related derivatives, less cash and cash equivalents and current available-for-sale investments. The BAT Group management board believes that this additional measure, which is used internally, is useful to the users of the financial statements in helping them to see how business financing has changed over the year. Net debt has limitations as an analytical tool. It is not a presentation made in accordance with IFRS and should not be considered as an alternative to borrowings or total liabilities determined in accordance with IFRS. Net debt is not necessarily comparable to similarly titled measures used by other companies. As a result, you should not consider this measure in isolation from, or as a substitute analysis for, the BAT Group's measures of

financial position or liquidity as determined in accordance with IFRS. See "*Summary Historical Consolidated Financial Data of BAT*" for additional information about net debt, as well as a reconciliation to total borrowings.

Independent Auditors

Effective March 23, 2015, KPMG LLP (UK) ("KPMG UK") are our independent public auditors. PricewaterhouseCoopers LLP ("PwC") were our independent auditors prior to that date. The reports of KPMG UK with respect to the audited consolidated financial statements of BAT as of December 31, 2016 and 2015 and for each of the years in the two-year period ended December 31, 2016, and with respect to the unaudited condensed consolidated financial statements as of June 30, 2017 and for the six months ended June 30, 2017, are in accordance with guidance issued by The Institute of Chartered Accountants in England and Wales. The report of PwC with respect to the audited consolidated financial statements of BAT as of December 31, 2014 and for the year ended December 31, 2014 are in accordance with guidance issued by The Institute of Chartered Accountants in England and Wales. The PwC report states that: "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". The KPMG UK reports with respect to the audited consolidated financial statements each state that: "This report is made solely to the Company's members as a body and is subject to important explanations and disclaimers regarding our responsibilities, published on our website at www.kpmg.com/uk/auditscopeukco2014a, which are incorporated into this report as if set out in full and should be read to provide an understanding of the purpose of this report, the work we have undertaken and the basis of our opinions." The KPMG UK report with respect to the unaudited condensed consolidated financial statements states that: "This report is made solely to the company in accordance with the terms of our engagement to assist the company in meeting the requirements of the DTR of the UK FCA. Our review has been undertaken so that we might state to the company those matters we are required to state to it in this report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company for our review work, for this report, or for the conclusions we have reached." The SEC would not permit such limiting language to be included in a registration statement or a prospectus used in connection with an offering of securities registered under the Securities Act, or in a report filed under the Exchange Act. If a U.S. court (or any other court) were to give effect to such limiting language, the recourse that investors in the Notes may have against KPMG UK or PwC, as applicable, based on their applicable reports or the consolidated financial statements to which they relate could be limited.

CURRENCIES AND EXCHANGE RATES

BAT publishes its consolidated financial statements in pounds sterling, while RAI publishes its consolidated financial statements in U.S. dollars. In this Offering Memorandum, references to "$", "dollars", "U.S. dollars" or "USD" are to the lawful currency of the United States of America, references to "£", "pounds sterling", "pence" or "GBP" are to the lawful currency of the United Kingdom, references to "Cdn$" and "Canadian dollars" are to the lawful currency of Canada, references to "€" or "euro" are to the single currency adopted by participating member states of the European Union, referred to as the EU, relating to Economic and Monetary Union, references to "Swiss franc" and "CHF" are to the lawful currency of Switzerland, references to "R$" and "Brazilian real" are to the lawful currency of Brazil, references to "South African rand" are to the lawful currency of South Africa and references to "Korean Won" are to the lawful currency of South Korea.

References to the "Sterling-Dollar exchange rate" refer to the pound sterling — U.S. dollar exchange rate as quoted by the Bloomberg Composite Rate on such date at the time of LSE market close, except (1) in relation to October 20, 2016 where it refers to the pound sterling — U.S. dollar exchange rate as quoted by the Bloomberg Composite Rate on such date at 9:00 p.m. UK time and (2) where another time is specified, in which case it refers to the pound sterling — U.S. dollar exchange rate as quoted by the Bloomberg Composite Rate on such date at such specified time.

The following table sets forth the high and low noon buying rates of each month of the last six months, as certified for customs purposes by the Federal Reserve Bank of New York, for the pound sterling expressed in U.S. dollars per pound sterling.

Period	High	Low
February 2017	1.2643	1.2427
March 2017	1.2583	1.2152
April 2017	1.2938	1.2398
May 2017	1.3018	1.2795
June 2017	1.2995	1.2628
July 2017	1.3124	1.2851

The following table sets forth for each year the average of the noon buying rates on the last business day of each month of that year, as certified for customs purposes by the Federal Reserve Bank of New York, for the pound sterling expressed in U.S. dollars per pound sterling for each of the five most recent fiscal years.

Period	Average
Year ended December 31, 2012	1.5924
Year ended December 31, 2013	1.5668
Year ended December 31, 2014	1.6461
Year ended December 31, 2015	1.5250
Year ended December 31, 2016	1.3444

On August 8, 2017, the noon buying rate was £1.00 = $1.3032.

The rates presented above may differ from the actual rates used in preparation of financial information appearing in this Offering Memorandum. The presentation of such rates is not meant to suggest that the U.S. dollar amounts actually represent the pound sterling amounts or that such amounts could have been converted to U.S. dollars at any particular rate.

INDUSTRY DATA

References to market share are the BAT Group's estimates based on the latest available data from a number of internal and external sources.

U.S. industry shipment volume and retail market share data for the RAI Group that appear in this Offering Memorandum have been obtained from Management Science Associates, Inc. ("MSAi"). This information is included in this Offering Memorandum because it is used primarily as an indicator of the relative performance of industry participants, brands and market trends. All U.S. market share results that appear, except as noted otherwise, in this document are based on U.S. cigarette (or smokeless tobacco products, as applicable) shipments to retail outlets, referred to as STR data, based on information submitted by wholesale locations and processed and managed by MSAi. However, you should not rely on the STR data reported by MSAi as being a precise measurement of actual market share as the shipments to retail outlets do not reflect actual consumer sales and do not track all volume and trade channels. Accordingly, the STR data of the U.S. tobacco industry as reported by MSAi may overstate or understate actual market share. Moreover, you should be aware that in a product market experiencing overall declining consumption, a particular product can experience increasing market share relative to competing products, yet still be subject to declining consumption volumes.

SECURITIES AND EXCHANGE COMMISSION REVIEW

The information included in this Offering Memorandum relates to an offering that is exempt from, or in certain cases not subject to, the registration requirements under the Securities Act. After completion of this offering, we will be required to use commercially reasonable efforts to (i) file a registration statement with the SEC with respect to a registered offer to exchange the Notes of each series offered hereby for new Notes of the same series having terms substantially identical to the Notes offered hereby (except that such new Notes will not contain terms with respect to transfer restrictions or the payment of additional interest) and (ii) in certain circumstances, file a shelf registration statement with respect to resales of the Notes of each series. See "*Registration Rights Agreement*". In the course of review by the SEC of the registration statement and other filings we make with the SEC, we may be required to make changes to the description of our business, financial statements and other information included in this Offering Memorandum. Comments by the SEC with respect to the registration statement may require the inclusion of additional information, as well as the modification, reformulation or deletion of the information we present. Any such modification, reformulation or deletion may be significant. This Offering Memorandum includes financial statements prepared in accordance with IFRS, however, any such registration statement will include financial statements prepared in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board, as required by SEC rules. The financial statements included in this Offering Memorandum may therefore differ from the financial statements included in any such registration statement. In addition, any such registration statement will include updated disclosure reflecting the passage of time from the date of this Offering Memorandum and the date of any such registration statement.

FORWARD-LOOKING STATEMENTS

Statements included in this Offering Memorandum regarding the BAT Group's future expectations, beliefs, plans, objectives, financial conditions, assumptions or future events or performance that are not historical facts are forward-looking statements. These statements are often, but not always, made through the use of words or phrases such as "anticipate", "believe", "could", "estimate", "expect", "intend", "may", "outlook", "plan", "positioned", "potential", "predict", "project", "should", "strategy", "will", "would" and similar expressions. All such forward-looking statements involve estimates and assumptions that are subject to risks, uncertainties and other factors that could cause actual future financial condition, performance and results to differ materially from the plans, goals, expectations and results expressed in the forward-looking statements and other financial and/or statistical data within this Offering Memorandum. Among the key factors that could have an adverse effect on the results of operations, cash flows and financial position of the BAT Group and any anticipated benefits of the merger, and that could cause actual results to differ materially from those projected in the forward-looking statements, are:

- competitive actions and pricing pressures in the marketplace, including competition from illicit sources;
- limitations on advertising and marketing of tobacco products;
- risks relating to government regulations or actions adversely affecting BAT's or RAI's business, including BAT becoming subject to substantial and increasing U.S. regulations, in particular in relation to the nicotine level or use of menthol in tobacco products, including by virtue of BAT's increased ownership in RAI;
- changes in tobacco-related, tax and other laws and regulations or the interpretation of such laws and regulations by governmental authorities;
- the outcome of pending or potential litigation, including tobacco litigation and significant monetary obligations imposed under State Settlement Agreements;
- economic, regulatory and geopolitical risks inherent in BAT's global operations;
- inability to obtain price increases;
- the continuing decline in cigarette consumption, or the overall consumption of legitimate tobacco products or the transition of adult tobacco consumers away from premium cigarette brands;
- fluctuations in the foreign exchange rates;
- potentially significant costs in the event of breaches of, or liabilities arising under, health and safety and environmental laws;
- liquidity, interest rate and counterparty risks;
- the possibility of not being able to develop, produce or market new products (including next generation products) profitably;
- failure to uphold high standards of corporate behavior, which can subject the BAT Group to potential liability under sanctions, anti-corruption and other similar laws;
- disruptions in information technology systems;
- the potential difficulty retaining key employees and maintaining business relationships;
- inability to achieve growth through successful mergers, acquisitions and joint ventures;
- termination of licenses to use certain brands and trademarks;
- intellectual property infringements;
- fluctuations in the availability, quality and price of raw materials and commodities, including tobacco leaf;
- loss of production capacity or key suppliers, distribution interruption, commodity risk or problems with labor relations;
- the indebtedness the BAT Group has incurred in connection with the merger, which can adversely affect the BAT Group's credit rating;
- the possibility that actual results of operations, cash flows and financial position of the BAT Group following the completion of the merger will materially differ from the Unaudited Pro Forma Financial Information;

- the failure of BAT to successfully integrate RAI into its business and to realize projected synergies and other benefits from the merger;
- disruption resulting from the merger, including the diversion of management's attention from ongoing business concerns;
- the incurrence of significant costs in connection with the merger; and
- increases in pension and postretirement expense.

For a further discussion of these and other risks, contingencies and uncertainties applicable to BAT and RAI, see "*Risk Factors*".

Due to such risks, contingencies and other uncertainties, you are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date of this Offering Memorandum. All subsequent written or oral forward-looking statements attributable to BAT or any person acting on its behalf are expressly qualified in their entirety by the cautionary statements contained or referred to in this section of the Offering Memorandum. BAT is not required to and does not undertake any obligation to update or revise publicly any forward-looking statements or other data or statements contained in this Offering Memorandum, whether as a result of new information, future events or otherwise, except as may be required under applicable law.

SUMMARY

The following overview is qualified in its entirety by, and should be read in conjunction with, the more detailed information appearing elsewhere in this Offering Memorandum. Capitalized terms used but not defined in this overview are defined elsewhere in this Offering Memorandum, including under "Certain Definitions". Investors should thoroughly consider this Offering Memorandum in its entirety, including the financial statements and related notes thereto included herein and the information set forth under "Available Information and Reports to Noteholders" and "Risk Factors", prior to an investment in the Notes.

History of BAT

BAT has had a significant global presence in the tobacco industry for over 100 years. The British-American Tobacco Company Ltd., referred to as BAT Ltd., was incorporated in 1902, when the Imperial Tobacco Company and the American Tobacco Company agreed to form a joint venture company. BAT Ltd. inherited companies and quickly expanded into major markets, including India and Ceylon, Egypt, Malaya, Northern Europe and East Africa. In 1927, BAT Ltd. expanded into the U.S. market through its acquisition of B&W. During the 1960s, 1970s and 1980s, the BAT Group diversified its business under the umbrella of B.A.T Industries p.l.c., with acquisitions in the paper, cosmetics, retail and financial services industries, among others. Various business reorganizations followed as the business was eventually refocused on the BAT Group's core cigarette, cigars and tobacco products businesses with British American Tobacco p.l.c. becoming a separately listed entity on the LSE in 1998.

In July 2004, the U.S. assets, liabilities and operations, other than certain specified assets and liabilities, of BAT's wholly owned subsidiary, B&W, were combined with RJR Tobacco Company. RAI was previously formed as a new holding company for these combined businesses. In connection with the B&W business combination, B&W acquired beneficial ownership of approximately 42% of RAI's outstanding common stock. In June 2015, in connection with the Lorillard merger, the BAT Group invested $4.7 billion to maintain its approximate 42% equity position in RAI following the Lorillard merger. On January 16, 2017, BAT and certain of its subsidiaries entered into the merger agreement with RAI, and on July 25, 2017, RAI became an indirect, wholly owned subsidiary of BAT after the consummation of the merger.

BAT's ordinary shares are listed on the LSE under the trading symbol "BATS" and are classified as a premium listing. BAT ordinary shares also have a secondary listing on the JSE under the abbreviated name "BATS" and the trading symbol "BTI".

BAT ordinary shares trade in the form of BAT ADSs in the United States, and the BAT ADSs are listed on the NYSE where they trade under the trading symbol "BTI".

BAT's principal executive offices are located at Globe House, 4 Temple Place, London WC2R 2PG, United Kingdom, and its telephone number is +44 (0) 207 845 1000. BAT's website address is *www.bat.com*. The web address of BAT has been included as an inactive textual reference only. BAT's website and the information contained therein or connected thereto are not intended to be incorporated into this Offering Memorandum.

Overview of our Business: British American Tobacco p.l.c.

BAT is the parent holding company of the BAT Group, a global tobacco and next generation products group with brands sold in over 200 markets. According to the BAT Group's internal estimates, the BAT Group is a market leader in more than 55 countries by volume, producing the cigarette chosen by one in eight of the world's one billion smokers. The BAT Group, excluding the BAT Group's associated undertakings, is organized into four regions: Asia-Pacific, Americas, Western Europe and Eastern Europe, Middle East and Africa, referred to as EEMEA.

The BAT Group manufactures and sells traditional tobacco products, which are composed of cigarettes, fine cut (roll-your-own and make-your-own tobacco), Swedish-style snus and cigars, alongside next generation products, including vapor products and tobacco heating products. The BAT Group's five global drive brands are Dunhill, Kent, Lucky Strike, Pall Mall and Rothmans. The BAT Group's cigarette portfolio also includes other international and local brands, such as Vogue, Viceroy, Kool, Peter Stuyvesant, Craven A, Benson & Hedges, John Player Gold Leaf, State Express 555 and Shuang Xi.

Overview of our Business: Reynolds American Inc.

RAI, the parent company of the RAI Group, is a holding company whose wholly owned operating subsidiaries include the second largest tobacco company in the United States, RJR Tobacco Company; SFNTC,

the manufacturer and marketer of the Natural American Spirit brand of cigarettes and other tobacco products in the United States; American Snuff Company, the second largest smokeless tobacco products manufacturer in the United States; R. J. Reynolds Vapor Company, referred to as RJR Vapor, a marketer of digital vapor cigarettes in the United States; Niconovum USA, Inc. and Niconovum AB, marketers of nicotine replacement therapy products in the United States and Sweden, respectively; and until their sale on January 13, 2016, SFR Tobacco International GmbH, referred to as SFRTI, and various foreign subsidiaries affiliated with SFRTI, distributors and marketers of the Natural American Spirit brand of cigarettes and other tobacco products outside the United States.

On July 25, 2017, RAI became an indirect, wholly owned subsidiary of BAT after the consummation of the merger.

RAI's reportable operating segments, prior to completion of the merger, included the RJR Tobacco segment, the Santa Fe segment and the American Snuff segment:

- The RJR Tobacco segment, prior to completion of the merger, consisted of the primary operations of RJR Tobacco Company and includes three of the top four best-selling cigarettes in the United States: Newport, Camel and Pall Mall. These brands, and RJR Tobacco's other brands, including Doral, Misty and Capri, are manufactured in a variety of styles and marketed in the United States. As part of its total tobacco strategy, RJR Tobacco offers a smokeless tobacco product, Camel Snus. Through the second quarter of 2017, RJR Tobacco managed contract manufacturing of cigarettes and tobacco products through arrangements with BAT affiliates, and managed the export of tobacco products to U.S. territories, U.S. duty-free shops and U.S. overseas military bases. In the United States, RJR Tobacco also manages the premium cigarette brands Dunhill, which RJR Tobacco Company licenses from the BAT Group, and State Express 555, which RJR Tobacco Company licenses from CTBAT International Co. Ltd., referred to as CTBAT, a joint venture between the BAT Group and China National Tobacco Corporation, referred to as CNTC.
- The Santa Fe segment, prior to completion of the merger, consisted of the primary operations of SFNTC and includes the manufacturing and marketing of premium cigarettes and other tobacco products under the Natural American Spirit brand in the United States.
- The American Snuff segment, prior to completion of the merger, consisted of the primary operations of American Snuff Company. American Snuff is the second largest smokeless tobacco products manufacturer in the United States, and offers adult tobacco consumers a range of differentiated smokeless tobacco products, primarily moist snuff. The moist snuff category is divided into premium, price-value and popular-price brands. American Snuff's primary brands include its largest selling moist snuff brands, Grizzly, in the price-value category, and Kodiak, in the premium category.

Included in All Other, prior to the completion of the merger, among other RAI subsidiaries, are RJR Vapor, Niconovum USA, Inc., Niconovum AB, and until their sale on January 13, 2016, SFRTI and various foreign subsidiaries affiliated with SFRTI.

RAI was incorporated in the State of North Carolina on January 2, 2004, and until July 24, 2017, its common stock was traded on the NYSE under the trading symbol "RAI".

Key Financial Results

In the six months ended June 30, 2017, the BAT Group's revenue was £7,717 million and its profit from operations was £2,574 million. In 2016, the BAT Group's revenue was £14,751 million and its profit from operations was £4,655 million.

In the six months ended June 30, 2017, RAI's net sales were $6,267 million and its operating income was $2,882 million. In 2016, RAI's net sales were $12,503 million and its operating income was $10,569 million.

In the six months ended June 30, 2017, assuming the merger occurred on January 1, 2016, the pro forma revenue of the BAT Group was £12,638 million and its profit from operations was £4,781 million. In 2016, assuming the merger occurred on January 1, 2016, the pro forma revenue of the BAT Group was £23,796 million and its profit from operations was £11,590 million.

Strengths

We believe that our principal strengths are the following:

Brand Portfolio

The BAT Group's five global drive brands are Dunhill, Kent, Lucky Strike, Pall Mall and Rothmans. The BAT Group's cigarette portfolio also includes other international and local brands, such as Benson & Hedges, Craven A, John Player Gold Leaf, Kool, Newport, Peter Stuyvesant, Shuang Xi, State Express 555, Viceroy and Vogue.

Geographic Spread

Our products are sold in more than 200 markets around the world and we have a leadership position in more than 55 markets.

Innovation Pipeline

We have introduced innovative tobacco and nicotine products throughout the world, have established routes to market to roll out our innovations and have strong in-house research and development capabilities.

Global Scale

We have a globally integrated supply chain, which spans direct agronomy support to leaf growers, direct and indirect procurement, tobacco products manufacturing and distribution.

People and Relationships

Our workforce is strongly multicultural and their diverse perspectives help us to succeed. We value our relationships with all of our partners, including leaf growers, suppliers and our retailers.

Next Generation Products

Our commitment to substantial investment in a range of next generation products, our understanding of the needs of adult consumers and our world-class research and development capabilities will help us succeed in this emerging category.

Strategy

Our vision is to be the world's best at satisfying consumer moments in tobacco and beyond. Our mission is to deliver our commitments to society, while championing informed consumer choice. Our strategy is based on four factors: *growth, productivity, building a winning organization* and *sustainability*. See *"Business — Strategy"*.

Growth

We will grow by understanding and delivering enjoyable consumer moments in combustibles and next generation products. Our approach is to be consumer led, product obsessed, brand distinct and excellent in execution.

Productivity

Productivity is a key pillar to support growth. It is about effectively deploying resources to increase profits and generate funds to invest behind growth. Our approach is to be operationally best, globally integrated and ensure cost and capital effectiveness.

Building a Winning Organization

To achieve our vision, we recognize that we must continue to have the right people, organized in the right teams and in the right working environment.

Sustainability

We want to ensure we continue to have a sustainable future so we can keep meeting the expectations of our adult consumers, our shareholders and other stakeholders. Our approach is to focus on three areas that are most significant for a sustainable future: harm reduction, sustainable agriculture and farmer livelihoods and corporate behavior.

The Merger

On July 25, 2017, the merger of BAT and RAI was completed. In evaluating the merger, the BAT Group considered a variety of factors with respect to the merger, including the following strategic factors (not necessarily in order of relative importance):

- Enhanced geographic coverage;
- Combined portfolio of global brands;
- Global next generation product business;
- Cost savings and synergies; and
- Growth prospects.

For more information on the transaction, including the factors considered by the BAT Group, see "*The Merger*".

Overview of the Issuer and the Guarantors

The Issuer

B.A.T Capital Corporation

BATCAP was incorporated under the laws of the State of Delaware, United States of America on April 6, 1981. BATCAP is domiciled in the State of Delaware. BATCAP is a wholly owned indirect subsidiary of BAT and its principal function is to operate as a financing company for the BAT Group. BATCAP does not have any subsidiary entities. The principal business office of BATCAP is located at 103 Foulk Road, Suite 120, Wilmington, Delaware 19803, United States of America.

The Guarantors

British American Tobacco p.l.c.

The Parent Guarantor was incorporated as a public limited liability company under the laws of England and Wales on July 23, 1997 and is registered as an external company in the Republic of South Africa. The Parent Guarantor is the BAT Group's parent holding company and its principal business office is located at Globe House, 4 Temple Place, London WC2R 2PG, United Kingdom.

B.A.T. International Finance p.l.c.

BATIF was incorporated as a private limited company under the laws of England and Wales on July 10, 1972 and was re-registered as a public limited company on September 8, 1981. BATIF's principal function is to operate as a financing company for the BAT Group. BATIF's principal business office is located at Globe House, 4 Temple Place, London WC2R 2PG, United Kingdom.

British American Tobacco Holdings (The Netherlands) B.V.

BATHTN was incorporated as a private company with limited liability (*besloten vennootschap met beperkte aansprakelijkheid*) under the laws of The Netherlands on February 24, 1992. BATHTN is an investment holding company and has its statutory seat (*statutaire zetel*) in Amstelveen, The Netherlands.

B.A.T. Netherlands Finance B.V.

BATNF was incorporated as a private company with limited liability (*besloten vennootschap met beperkte aansprakelijkheid*) under the laws of The Netherlands on April 23, 2014. BATNF's principal function is to operate as a financing company for the BAT Group and its statutory seat (*statutaire zetel*) is in Amstelveen, The Netherlands.

Reynolds American Inc.

Reynolds American Inc. was incorporated in the State of North Carolina on January 2, 2004. RAI is the RAI Group's parent holding company and, its registered office is located at 401 North Main Street, Winston-Salem, North Carolina 27101.

THE OFFERING

Issuer	B.A.T Capital Corporation
Guarantors	The Notes will be guaranteed by British American Tobacco p.l.c., British American Tobacco Holdings (The Netherlands) B.V., B.A.T. Netherlands Finance B.V., B.A.T. International Finance p.l.c., and, unless released in accordance with the provisions of the Indenture, Reynolds American Inc.
Notes	$2,250,000,000 of 2.297% Notes due 2020 $2,250,000,000 of 2.764% Notes due 2022 $2,500,000,000 of 3.222% Notes due 2024 $3,500,000,000 of 3.557% Notes due 2027 $2,500,000,000 of 4.390% Notes due 2037 $2,500,000,000 of 4.540% Notes due 2047 (collectively, the "Fixed Rate Notes") $1,000,000,000 of Floating Rate Notes due 2020 $750,000,000 of Floating Rate Notes due 2022 (collectively, the "Floating Rate Notes"). In this Offering Memorandum, we refer to the Fixed Rate Notes and the Floating Rate Notes as the "Notes". In this Offering Memorandum, we refer to each of the Fixed Rate Notes and the Floating Rate Notes as a "series" of Notes.
The Guarantees	The obligations of the Issuer under the Notes will be fully, unconditionally and irrevocably guaranteed on a senior and unsecured basis by each of the Parent Guarantor, the Dutch Guarantors, BATIF, and RAI. As described below, the guarantee of the Notes provided by Subsidiary Guarantors (including RAI) other than BATIF and the Dutch Guarantors will be automatically released under certain circumstances.
Subsidiary Guarantee Release	Any Guarantor of the Notes that is a subsidiary of the Parent Guarantor (a "Subsidiary Guarantor") (including RAI), other than BATIF and the Dutch Guarantors, will automatically and unconditionally be released from all obligations under its Guarantee, and such Guarantee shall thereupon terminate and be discharged and of no further force or effect, in the event that (1) its guarantee of all then outstanding notes issued under the EMTN Programme (as defined in the "*Description of the Notes and the Guarantees*") is released or (2) at substantially the same time its Guarantee of the Notes is terminated, the Subsidiary Guarantor is released from all obligations in respect of indebtedness for borrowed money for which such Subsidiary Guarantor is an obligor (as a guarantor or borrower). For purposes of this paragraph, the amount of a Subsidiary Guarantor's indebtedness for borrowed money shall not include (A) the Notes issued pursuant to the Indenture, (B) any other debt the terms of which permit the termination of such Subsidiary Guarantor's guarantee of such debt under similar circumstances, as long as such Subsidiary Guarantor's obligations in respect of such other debt are terminated at substantially the same time as its guarantee of the Notes, (C) any debt that is being refinanced at substantially the same time that the guarantee of the Notes is being released, provided that any obligations of the relevant Subsidiary Guarantor in respect of the debt that is incurred in the refinancing shall be included in the calculation of the relevant Subsidiary Guarantor's indebtedness for borrowed money and (D) for the avoidance of doubt, any debt in respect of which such Subsidiary Guarantor is

	an obligor (as a guarantor or borrower) (i) between or among the Parent Guarantor and any subsidiary or subsidiaries thereof or (ii) between or among any subsidiaries of the Parent Guarantor. See "*Description of the Notes and the Guarantees — Status of the Notes — Release*".
The Offering	The Notes are being offered and sold by the Initial Purchasers (i) in the United States to QIBs in reliance on Rule 144A and (ii) outside the United States to persons other than U.S. persons in reliance upon Regulation S.
Issue Price	2020 Fixed Rate Notes: 100%, plus accrued interest, if any, from August 15, 2017. 2022 Fixed Rate Notes: 100%, plus accrued interest, if any, from August 15, 2017. 2024 Fixed Rate Notes: 100%, plus accrued interest, if any, from August 15, 2017. 2027 Fixed Rate Notes: 100%, plus accrued interest, if any, from August 15, 2017. 2037 Fixed Rate Notes: 100%, plus accrued interest, if any, from August 15, 2017. 2047 Fixed Rate Notes: 100%, plus accrued interest, if any, from August 15, 2017. 2020 Floating Rate Notes: 100%, plus accrued interest, if any, from August 15, 2017. 2022 Floating Rate Notes: 100%, plus accrued interest, if any, from August 15, 2017.
Issue Date	August 15, 2017.
Maturity Date	2020 Fixed Rate Notes: August 14, 2020. 2022 Fixed Rate Notes: August 15, 2022. 2024 Fixed Rate Notes: August 15, 2024. 2027 Fixed Rate Notes: August 15, 2027. 2037 Fixed Rate Notes: August 15, 2037. 2047 Fixed Rate Notes: August 15, 2047. 2020 Floating Rate Notes: August 14, 2020. 2022 Floating Rate Notes: August 15, 2022.
Interest	2020 Fixed Rate Notes: 2.297% per annum, payable semi-annually in arrear. 2022 Fixed Rate Notes: 2.764% per annum, payable semi-annually in arrear. 2024 Fixed Rate Notes: 3.222% per annum, payable semi-annually in arrear. 2027 Fixed Rate Notes: 3.557% per annum, payable semi-annually in arrear. 2037 Fixed Rate Notes: 4.390% per annum, payable semi-annually in arrear. 2047 Fixed Rate Notes: 4.540% per annum, payable semi-annually in arrear. The 2020 Floating Rate Notes will bear interest equal to LIBOR plus 0.59%, as determined by the Calculation Agent, payable quarterly in arrear. The interest rate on the 2020 Floating Rate Notes for each subsequent interest period will be reset quarterly on each 2020 Floating Rate Notes interest payment date. The 2022 Floating Rate Notes will bear interest equal to LIBOR plus 0.88%, as determined by the Calculation Agent, payable quarterly in arrear. The interest rate on the 2022 Floating Rate Notes for each subsequent interest period will be reset quarterly on each 2022 Floating Rate Notes interest payment date.

Interest Payment Dates	February 14 and August 14 of each year, commencing on February 14, 2018 until the Maturity Date in respect of the 2020 Fixed Rate Notes. February 15 and August 15 of each year, commencing on February 15, 2018 until the relevant Maturity Date in respect of the 2022 Fixed Rate Notes, the 2024 Fixed Rate Notes, the 2027 Fixed Rate Notes, the 2037 Fixed Rate Notes and the 2047 Fixed Rate Notes. February 14, May 14, August 14 and November 14 of each year, commencing on November 14, 2017 until the Maturity Date in respect of the 2020 Floating Rate Notes. February 15, May 15, August 15 and November 15 of each year, commencing on November 15, 2017 until the Maturity Date in respect of the 2022 Floating Rate Notes.
Status of the Notes and the Guarantees	The Notes and the Guarantees will be direct, unsecured and unsubordinated obligations of the Issuer and each of the Guarantors, respectively, ranking *pari passu* among themselves and with all other direct, unsecured and unsubordinated obligations (except those obligations preferred by statute or operation of law) of the Issuer and each of the Guarantors, respectively, from time to time outstanding. The Notes and the Guarantees will be effectively subordinated to any debt or other obligations of any subsidiary of BAT, with respect to the earnings and assets of that subsidiary. See "*Description of the Notes and the Guarantees — Status of the Notes and Guarantees*".
Use of Proceeds	The net proceeds from the offering of the Notes will be used to repay a portion of amounts outstanding under the acquisition facility, pay merger related fees and expenses and for general corporate purposes, which may include the repayment of certain outstanding debt. See "*Use of Proceeds*".
Covenants	Each of the Issuer and the Guarantors has agreed to observe certain covenants with respect to the Notes and the Guarantees. See "*Description of the Notes and the Guarantees — Covenants of the Issuer and the Guarantors*".
Events of Default	For a discussion of certain events that will permit the acceleration of the Notes, including acceleration of certain other indebtedness of the Issuer and the Guarantors, see "*Description of the Notes and the Guarantees — Events of Default*".
Optional Redemption	(i) At all times in respect of the 2020 Fixed Rate Notes or (ii) before the applicable Par Call Date (as defined in "*Description of the Notes and the Guarantees — Redemption — Optional Redemption*") for all other series of Fixed Rate Notes, the Issuer may redeem the relevant series of Fixed Rate Notes in whole or in part, at its option, at any time and from time to time at a redemption price equal to the greater of (x) 100% of the principal amount of the relevant series of Fixed Rate Notes to be redeemed and (y) the sum of the present values of the applicable Remaining Scheduled Payments (as defined in "*Description of the Notes and the Guarantees — Redemption — Optional Redemption*") discounted to the date of redemption on a semi-annual basis (assuming a 360-day year consisting of twelve 30-day months or, in the case of an incomplete month, the number of days elapsed) at the Treasury Rate (as defined in "*Description of the Notes and the Guarantees — Redemption — Optional Redemption*"),

plus:

in the case of the 2020 Fixed Rate Notes, 15 basis points
in the case of the 2022 Fixed Rate Notes, 15 basis points
in the case of the 2024 Fixed Rate Notes, 20 basis points
in the case of the 2027 Fixed Rate Notes, 20 basis points
in the case of the 2037 Fixed Rate Notes, 25 basis points
in the case of the 2047 Fixed Rate Notes, 30 basis points

together with, in each case:

accrued interest on the principal amount of the relevant series of Fixed Rate Notes to be redeemed to the date of redemption. See "*Description of the Notes and the Guarantees — Redemption — Optional Redemption*".

For the 2022 Fixed Rate Notes, the 2024 Fixed Rate Notes, the 2027 Fixed Rate Notes, the 2037 Fixed Rate Notes, the 2047 Fixed Rate Notes and the 2022 Floating Rate Notes, on or after the applicable Par Call Date (as defined in "*Description of the Notes and the Guarantees — Redemption — Optional Redemption*"), if any, the Issuer may redeem the relevant series of Notes, in whole or in part, at its option, at a redemption price equal to 100% of the principal amount of the Notes of such series to be redeemed, plus accrued and unpaid interest on the principal amount being redeemed to, but not including, the redemption date. See "*Description of the Notes and the Guarantees — Redemption — Optional Redemption*".

The 2020 Fixed Rate Notes and the 2020 Floating Rate Notes will not be subject to such optional redemption summarized in the previous paragraph by the Issuer.

Redemption for Tax Reasons . . . . The Issuer may redeem in whole but not in part, at its option, the relevant series of Notes at a redemption price equal to 100% of the outstanding principal amount of such Notes, plus any accrued and unpaid interest to the date of redemption, if the Issuer or a Guarantor becomes obligated to pay Additional Amounts (as defined in "*Description of the Notes and the Guarantees — Payment of Additional Amounts*") due to a Change in Tax Law (as defined in "*Description of the Notes and the Guarantees — Redemption — Redemption for Tax Reasons*") with respect to such series of Notes or payments under the Guarantees in respect thereof. See "*Description of the Notes and the Guarantees — Redemption — Redemption for Tax Reasons*".

Payment of Additional Amounts . . . . Subject to certain exceptions and limitations, the Issuer or, if applicable, each Guarantor will pay to the holder of a Note such Additional Amounts on the Note as may be necessary to ensure that the net amounts received by such holder after all withholding or deductions, if any, will not be less than the amount of principal (and premium, if any) and interest which such holder would have received in respect of such Note (or payments under the Guarantees in respect thereof) in the absence of such withholding or deduction. See "*Description of the Notes and the Guarantees — Payment of Additional Amounts*".

Denomination, Form and Registration of Notes . . . . The Notes will be issued in fully registered form and only in denominations of $2,000 and integral multiples of $1,000 in excess thereof. The Notes will be issued initially as Global Notes.

Further Issues	The aggregate principal amount of Notes issuable under the Indenture is unlimited. The Issuer may, from time to time, without notice to or the consent of the holders of the Notes in respect of any series of the Notes "reopen" such series of the Notes and create and issue additional notes having substantially the same terms and conditions as the Notes issued hereunder. See "*Description of the Notes and the Guarantees — Further Issues*".
Trustee	Wilmington Trust, National Association.
Registration Rights	Pursuant to a Registration Rights Agreement with respect to the Notes and the Guarantees to be entered into among the Issuer, the Guarantors and the Initial Purchasers as part of this offering, the Issuer and the Guarantors will agree to use commercially reasonable efforts to (i) file a registration statement with the SEC with respect to a registered offer to exchange the Notes of each series offered hereby for new Notes of the same series having terms substantially identical to the Notes offered hereby (except that such new Notes will not contain terms with respect to transfer restrictions or the payment of additional interest) and (ii) in certain circumstances, file a shelf registration statement with respect to resales of the Notes of each series. For more information, see "*Registration Rights Agreement*".
Transfer Restrictions	The Notes and the Guarantees have not been registered under the Securities Act and accordingly may be offered or sold only (i) in the United States to QIBs in reliance upon the exemption from the registration requirement of the Securities Act provided by Rule 144A and (ii) outside the United States to persons other than U.S. persons in reliance upon Regulation S and only in circumstances which do not require the publication by the Issuer of a prospectus pursuant to Article 3 of Directive 2003/71/EC, as amended. See "*Notice to Investors*".
Tax Consequences	For a discussion of the possible income tax consequences of an investment in the Notes, see "*Certain Taxation Considerations*". You should consult your own tax advisor to determine the tax consequences of an investment in the Notes.
Governing Law	The Indenture, the Notes and the Guarantees will be governed by, and construed in accordance with, the laws of the State of New York.
Listing	Prior to the issuance of the Notes, the BAT Group will use its best efforts to obtain admission of each series of Notes to the Official List of the UK Listing Authority and to trading on the PSM.
Risk Factors	Investing in the Notes involves risks. Prior to investing in the Notes, prospective investors should consider, together with the other information set out in this Offering Memorandum, the factors and risks attaching to an investment in the Notes. See "*Risk Factors*".
CUSIP	
2020 Fixed Rate Notes	Rule 144A: 05526DAQ8 Regulation S: U05526AE5
2022 Fixed Rate Notes	Rule 144A: 05526DAU9 Regulation S: U05526AG0
2024 Fixed Rate Notes	Rule 144A: 05526DAY1 Regulation S: U05526AJ4

2027 Fixed Rate Notes . . . . Rule 144A: 05526DBA2
Regulation S: U05526AK1

2037 Fixed Rate Notes . . . . Rule 144A: 05526DBC8
Regulation S: U05526AL9

2047 Fixed Rate Notes . . . . Rule 144A: 05526DBE4
Regulation S: U05526AM7

2020 Floating Rate Notes . . . . Rule 144A: 05526DAS4
Regulation S: U05526AF2

2022 Floating Rate Notes . . . . Rule 144A: 05526DAW5
Regulation S: U05526AH8

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2020 Fixed Rate Notes . . . . Rule 144A: US05526DAQ88
Regulation S: USU05526AE50

2022 Fixed Rate Notes . . . . Rule 144A: US05526DAU90
Regulation S:USU05526AG09

2024 Fixed Rate Notes . . . . Rule 144A: US05526DAY13
Regulation S: USU05526AJ48

2027 Fixed Rate Notes . . . . Rule 144A: US05526DBA28
Regulation S: USU05526AK11

2037 Fixed Rate Notes . . . . Rule 144A: US05526DBC83
Regulation S: USU05526AL93

2047 Fixed Rate Notes . . . . Rule 144A: US05526DBE40
Regulation S: USU05526AM76

2020 Floating Rate Notes . . . . Rule 144A: US05526DAS45
Regulation S: USU05526AF26

2022 Floating Rate Notes . . . . Rule 144A: US05526DAW56
Regulation S: USU05526AH81

SUMMARY HISTORICAL CONSOLIDATED FINANCIAL DATA OF BAT

The following table presents summary historical consolidated financial data of BAT prepared in accordance with IFRS. The summary historical consolidated financial data as of December 31, 2016, 2015 and 2014 and for each of the years in the three-year period ended December 31, 2016 are derived from the BAT Group's audited consolidated financial statements and accompanying notes, which are included in this Offering Memorandum.

The unaudited summary historical consolidated financial data as of June 30, 2017 and 2016 and for the six months ended June 30, 2017 and 2016 are derived from the BAT Group's unaudited condensed consolidated financial statements and accompanying notes, which are included in this Offering Memorandum. The unaudited summary historical financial data presented have been prepared on a basis consistent with BAT's audited consolidated financial statements. In the opinion of BAT management, such unaudited financial data reflect all adjustments, consisting only of normal and recurring adjustments, necessary for a fair presentation of the results for those periods. The results of operations for the interim periods are not necessarily indicative of the results to be expected for the full year or any future period.

The information set forth below is only a summary and is not necessarily indicative of the results of BAT or the BAT Group following completion of the merger, and you should read the following information together with the BAT Group's consolidated financial statements, the BAT Group's unaudited condensed consolidated financial statements and the sections entitled "*Management's Discussion and Analysis of Financial Condition and Results of Operations of BAT*".

	As of and for the Six Months Ended June 30,[1]		As of and for the Year Ended December 31,[1]		
	2017	2016	2016	2015	2014
	(£ millions)				
Income statement data:					
Revenue[2]	7,717	6,669	14,751	13,104	13,971
Raw materials and consumables used	(1,881)	(1,630)	(3,777)	(3,217)	(3,088)
Changes in inventories of finished goods and work in progress	(59)	8	44	184	58
Employee benefit costs	(1,144)	(1,034)	(2,274)	(2,039)	(2,194)
Depreciation, amortization and impairment costs	(346)	(253)	(607)	(428)	(523)
Other operating income	55	49	176	225	178
Other operating expenses	(1,768)	(1,596)	(3,658)	(3,272)	(3,856)
Profit from operations	2,574	2,213	4,655	4,557	4,546
Net finance (costs)/income	(325)	(233)	(637)	62	(417)
Share of post-tax results of associates and joint ventures	778	1,446	2,227	1,236	719
Profit before taxation	3,027	3,426	6,245	5,855	4,848
Taxation on ordinary activities	(680)	(685)	(1,406)	(1,333)	(1,455)
Profit for the year	2,347	2,741	4,839	4,522	3,393
Balance sheet data:					
Assets:					
Non-current assets	27,712	25,550	27,414	21,701	17,035
Current assets	11,474	10,689	12,359	9,814	9,132
Total assets	39,186	36,239	39,773	31,515	26,167
Liabilities:					
Non-current liabilities	18,081	18,200	19,511	17,477	11,584
Current liabilities	13,196	11,787	11,856	9,006	8,769
Total borrowings	20,907	20,231	19,495	17,001	12,258
Equity:					
Share capital	507	507	507	507	507
Total equity	7,909	6,252	8,406	5,032	5,814
Cash flow data:					
Net cash generated from operating activities	1,706	1,054	4,610	4,720	3,716
Net cash used in investing activities	(297)	(220)	(640)	(3,991)	(470)
Net cash used in financing activities	(1,511)	(1,051)	(4,229)	(219)	(3,467)

(1) All of the information above is in respect of continuing operations. The historical financial data for the six months ended June 30, 2017 and 2016 is unaudited.

(2) Revenue is net of duty, excise and other taxes of £32,136 million, £27,896 million, and £28,535 million for the years ended December 31, 2016, 2015, and 2014, respectively, and £17,377 million and £14,364 million for the six months ended June 30, 2017 and 2016, respectively.

	As of and for the Six Months Ended June 30,		As of and for the Year Ended December 31,		
	2017	2016	2016	2015	2014
	(£ millions, except volume information)				
Other data (unaudited):					
Group cigarette volume, in billions[1]	314	332	665	663	667
Adjusted profit from operations[2]	2,841	2,452	5,480	4,992	5,403
Free cash flow[3]	1,083	559	3,389	3,481	2,507
Net debt[4]	18,481	17,735	16,767	14,794	10,165

(1) In addition to revenue and the other measures discussed in this Offering Memorandum, BAT management focuses on volume as a key measure to evaluate performance. Volume is an unaudited operating measure and is calculated as the total global cigarette volume of the BAT Group's brands sold by its subsidiaries. The BAT Group believes that volume is a measure commonly used by analysts and investors in the industry. Accordingly, this information has been included to permit a more complete analysis of the BAT Group's operating performance.

(2) To supplement BAT's results from operations presented in accordance with IFRS, the BAT Group management board, as the chief operating decision maker, reviews current and prior year adjusted profit from operations to evaluate the underlying business performance of the BAT Group and its geographic segments, to allocate resources to the overall business and to communicate financial performance to investors. Adjusted profit from operations is not a measure defined by IFRS. The most directly comparable IFRS measure to adjusted profit from operations is profit from operations. Adjusted profit from operations is defined as profit from operations before adjusting items in profit from operations. Adjusting items, as identified in accordance with the BAT Group's accounting policies, represent certain items of income and expense which the BAT Group considers distinctive based on their size, nature or incidence. In identifying and quantifying adjusting items, the BAT Group consistently applies a policy that defines criteria that are required to be met for an item to be classified as adjusting and provides details of items that are specifically excluded from being classified as adjusting items. Adjusting items in profit from operations include restructuring and integration costs, amortization of trademarks and similar intangibles, and a payment and release of a provision relating to non-tobacco litigation. The definition of adjusting items is explained within note 1 to the BAT Group's consolidated financial statements included in this Offering Memorandum.

The BAT Group management board believes that adjusted profit from operations is an additional measure that is useful to investors, and is used by the BAT Group management board as described in the paragraph above, because it excludes the impact of adjusting items in profit from operations, which have less bearing on the routine operating activities of the BAT Group, thereby enhancing users' understanding of underlying business performance. The BAT Group management board also believes that adjusted profit from operations provides information that enables investors to better compare the BAT Group's business performance across periods. Additionally, the BAT Group management board believes that similar measures are frequently used by securities analysts, investors, and other interested parties in their evaluation of companies comparable to the BAT Group, many of which present an adjusted operating profit-related performance measure when reporting their results. Adjusted profit from operations has limitations as an analytical tool. It is not a presentation made in accordance with IFRS, is not a measure of financial condition or liquidity and should not be considered as an alternative to profit for the year or profit from operations as determined in accordance with IFRS. Adjusted profit from operations is not necessarily comparable to similarly titled measures used by other companies. As a result, you should not consider this performance measure in isolation from, or as a substitute analysis for, BAT's results of operations as determined in accordance with IFRS.

The table below reconciles BAT Group's profit from operations to adjusted profit from operations for the periods presented. Refer to note 2 to the BAT Group's consolidated financial statements and the note 2 to the BAT Group's unaudited condensed consolidated financial statements included in this Offering Memorandum for further discussion of the segmental results and for the reconciliation of adjusted profit from operations at current and constant rates of exchange to segmental profit from operations and to group profit for the year for the years ended December 31, 2016, 2015 and 2014. Refer to note 2 to the BAT Group's unaudited condensed consolidated financial statements included in this Offering Memorandum for further discussion of the segmental results and for the reconciliation of adjusted profit from operations at current and constant rates of exchange to segmental profit from operations and to group profit for six-month periods ended June 30, 2017 and 2016.

	For the Six Months Ended June 30,		For the Year Ended December 31,		
	2017	**2016**	**2016**	**2015**	**2014**
			(£ millions)		
Profit from operations	**2,574**	**2,213**	**4,655**	**4,557**	**4,546**
Less:					
Restructuring and integration costs	133	161	603	367	452
Amortization of trademarks and similar intangibles	134	58	149	65	58
Fox River	—	20	20	—	(27)
South Korea sales tax	—	—	53	—	—
Flinkote.	—	—	—	3	374
Adjusted profit from operations	**2,841**	**2,452**	**5,480**	**4,992**	**5,403**

(3) The BAT Group uses free cash flow to illustrate the cash flows before transactions relating to borrowings. BAT defines free cash flow as net cash generated from operating activities adjusted for dividends paid to non-controlling interests, net interest paid, net capital expenditure and proceeds from associates' share buy-backs. Free cash flow is not a measure defined by IFRS. The most directly comparable IFRS measure to free cash flow is net cash generated from operating activities. The BAT Group management board believes that this additional measure, which is used internally, is useful to the users of the financial statements in helping them understand the underlying business performance and can provide insight into the cash flow available to, among other things, reduce debt and pay dividends. Free cash flow has limitations as an analytical tool. It is not a presentation made in accordance with IFRS and should not be considered as an alternative to net cash generated from operating activities determined in accordance with IFRS. Free cash flow is not necessarily comparable to similarly titled measures used by other companies. As a result, you should not consider this measure in isolation from, or as a substitute analysis for, the BAT Group's results of operations or cash flows as determined in accordance with IFRS. The table below reconciles net cash generated from operating activities to free cash flow for the periods presented.

	For the Six Months Ended June 30,		For the Year Ended December 31,		
	2017	**2016**	**2016**	**2015**	**2014**
			(£ millions)		
Net cash generated from operating activities	**1,706**	**1,054**	**4,610**	**4,720**	**3,716**
Dividends paid to non-controlling interests	(106)	(94)	(147)	(235)	(249)
Net interest paid	(326)	(276)	(537)	(522)	(426)
Net capital expenditure	(187)	(126)	(559)	(483)	(627)
Proceeds from associates' share buy-backs	—	—	23	—	94
Other	(4)	1	(1)	—	—
Free cash flow	**1,083**	**559**	**3,389**	**3,481**	**2,507**

(4) The BAT Group uses net debt to assess its financial capacity. Net debt is not a measure defined by IFRS. The most directly comparable IFRS measure to net debt is total borrowings. The BAT Group defines net debt as total borrowings, including related derivatives, less cash and cash equivalents and current available-for-sale investments. The BAT Group management board believes that this additional measure, which is used internally, is useful to the users of the financial statements in helping them to see how business financing has changed over the year. Net debt has limitations as an analytical tool. It is not a presentation made in accordance with IFRS and should not be considered as an alternative to borrowings or total liabilities determined in accordance with IFRS. Net debt is not necessarily comparable to similarly titled measures used by other companies. As a result, you should not consider this measure in isolation from, or as a substitute analysis for, the BAT Group's measures of financial position or liquidity as determined in accordance with IFRS. The table below reconciles net debt to total borrowings for the periods presented.

	As of the Six Months Ended June 30,	As of the Year Ended December 31,		
	2017	**2016**	**2015**	**2014**
		(£ millions)		
Total borrowings	**20,907**	**19,495**	**17,001**	**12,258**
Derivatives in respect of net debt	(381)	(509)	(209)	(225)
Cash and cash equivalents	(2,019)	(2,204)	(1,963)	(1,818)
Current available-for-sale investments	(26)	(15)	(35)	(50)
Net debt	**18,481**	**16,767**	**14,794**	**10,165**

SUMMARY HISTORICAL CONSOLIDATED FINANCIAL DATA OF RAI

The following table presents summary historical consolidated financial data of RAI prepared in accordance with U.S. GAAP. The summary historical consolidated financial data as of December 31, 2016, 2015, and 2014 and for each of the years in the three-year period ended December 31, 2016, are derived from the RAI Group's consolidated financial statements and accompanying notes, which are included in this Offering Memorandum.

The unaudited summary historical financial data of RAI as of June 30, 2017, and for the six months ended June 30, 2017 and 2016, are derived from the RAI Group's unaudited condensed consolidated financial statements and accompanying notes, which are included in this Offering Memorandum. The unaudited summary historical financial data presented have been prepared on a basis consistent with RAI's consolidated financial statements. In the opinion of BAT Group management, such unaudited financial data reflect all adjustments, consisting only of normal and recurring adjustments, necessary for a fair presentation of the results for those periods. The results of operations for the interim periods are not necessarily indicative of the results to be expected for the full year or any future period.

The summary historical consolidated financial data below includes the results of Lorillard from its acquisition date of June 12, 2015 onwards. In light of the Lorillard merger and the Lorillard Divestiture of certain assets in relation thereto, RAI's results of operations for the six months ended June 30, 2017 and 2016 and the years ended December 31, 2016 and 2015, and financial positions as at June 30, 2017 and December 31, 2016 and 2015 are not directly comparable to prior reporting periods. The information set forth below is only a summary and is not necessarily indicative of the results of RAI or the BAT Group following completion of the merger, and you should read the following information together with the RAI Group's consolidated financial statements, the RAI Group's unaudited condensed consolidated financial statements and the sections entitled "*Management's Discussion and Analysis of Financial Condition and Results of Operations of RAI*".

	As of and for the Six Months Ended June 30, (unaudited)		As of and for the Years Ended December 31,		
	2017	2016[1]	2016[1]	2015[2]	2014
	(dollars in millions)				
Results of Operations:					
Net sales[3]	$ 6,201	$ 6,003	$12,277	$10,416	$ 8,160
Net sales, related party[4]	66	109	226	259	311
Net sales[3]	6,267	6,112	12,503	10,675	8,471
Costs and expenses					
Cost of products sold[3]	2,477	2,440	4,841	4,688	4,058
Selling, general and administrative expenses	896	964	1,931	2,098	1,871
Gain on divestiture	—	(4,861)	(4,861)	(3,181)	—
Amortization expense	12	12	23	18	11
Asset impairment and exit charges	—	—	—	99	—
Operating income	2,882	7,557	10,569	6,953	2,531
Interest and debt expense	299	326	626	570	286
Interest income	(5)	(5)	(8)	(6)	(3)
Other (income) expense, net	15	251	260	5	(14)
Income from continuing operations before income taxes	2,573	6,985	9,691	6,384	2,262
Provision for income taxes	874	2,624	3,618	3,131	817
Income from continuing operations[5]	1,699	4,361	6,073	3,253	1,445
Income from discontinued operations, net of tax	—	—	—	—	25
Net income	$ 1,699	$ 4,361	$ 6,073	$ 3,253	$ 1,470
Balance Sheet Data (at end of periods):					
Current assets[6]	$ 3,636		$ 4,238	$ 5,155	$ 2,619
Total assets[7]	50,463		51,095	52,100	14,781
Current liabilities	5,542		4,985	5,291	3,544
Long-term debt (less current maturities)[8]	11,390		12,664	16,849	4,602
Total liabilities[7]	28,577		29,384	33,848	10,259
Shareholders' equity	21,886		21,711	18,252	4,522

	As of and for the Six Months Ended June 30, (unaudited)		As of and for the Years Ended December 31,		
	2017	2016(1)	2016(1)	2015(2)	2014
	(dollars in millions)				
Cash Flow Data:					
Net cash from (used in) operating activities	$ 1,277	$ (725)	$ 1,280	$ 196	$ 1,623
Net cash from (used in) investing activities	(65)	5,103	5,078	(10,005)	(205)
Net cash from (used in) financing activities	(1,523)	(5,034)	(6,866)	11,438	(1,918)
Net cash related to discontinued operations, net of tax benefit	—	—	—	—	25

(1) Reflects impact of the sale of the international rights to the Natural American Spirit brand that occurred on January 13, 2016.

(2) Reflects impact of the Lorillard merger and the Lorillard Divestiture.

(3) Net sales and cost of products sold exclude excise taxes of $2,065 million and $2,150 million for the six months ended June 30, 2017 and 2016, respectively, and $4,343 million, $4,209 million, and $3,625 million for the years ended December 31, 2016, 2015, and 2014, respectively.

(4) Reflects sales to the BAT Group.

(5) This line item includes NPM Adjustment credits of $92 million and $189 million for the six months ended June 30, 2017 and 2016, respectively, and $390 million, $297 million and $345 million for the years ended December 31, 2016, 2015 and 2014, respectively.

(6) This line item includes a reclassification due to the adoption of Accounting Standards Updates 2015-17 and 2015-03 and was reduced by $1.0 billion and $704 million as of December 31, 2015 and 2014, respectively.

(7) This line item includes a reclassification due to the adoption of Accounting Standards Updates 2015-17 and 2015-03 and was reduced by $1.1 billion and $415 million as of December 31, 2015 and 2014 respectively.

(8) This line item includes a reclassification due to the adoption of Accounting Standards Update 2015-03 and was reduced by $92 million and $31 million as of December 31, 2015 and 2014, respectively.

SUMMARY BAT UNAUDITED PRO FORMA CONDENSED COMBINED FINANCIAL DATA

The summary BAT unaudited pro forma condensed combined financial data is extracted directly from the BAT Unaudited Pro Forma Information included in the section "*BAT Unaudited Pro Forma Condensed Combined Financial Information*". As described in that section, the Unaudited Pro Forma Financial Information is based upon (i) the BAT Group's consolidated financial statements, and the BAT Group's unaudited condensed consolidated financial statements and (ii) the RAI Group's consolidated financial statements and the RAI Group's unaudited condensed consolidated financial statements. The Unaudited Pro Forma Financial Information has been prepared to illustrate the effects of the merger, including the financing structure established to fund the merger, but excluding the offering of the Notes, (i) as if it had occurred on January 1, 2016 in respect of the unaudited pro forma condensed combined income statement for the year ended December 31, 2016 and in respect of the unaudited pro forma condensed combined income statement for the six months ended June 30, 2017 and (ii) as if it had occurred on June 30, 2017 in respect of the unaudited pro forma condensed combined balance sheet.

The Unaudited Pro Forma Financial Information has been prepared using the acquisition method of accounting in accordance with IFRS 3, Business Combinations, which requires that one company is designated as the acquirer for accounting purposes. BAT will be treated as the accounting acquirer, and accordingly, the RAI assets acquired and liabilities assumed will be adjusted based on preliminary estimates of fair value. The actual fair values will be determined at a subsequent date and may vary materially from these preliminary estimates.

The Unaudited Pro Forma Financial Information is provided for illustrative purposes only and, because of its nature, addresses a hypothetical situation and therefore does not represent the BAT Group's or the RAI Group's actual financial position or results. The Unaudited Pro Forma Financial Information is based upon the best available information and certain assumptions that BAT believes to be reasonable. The Unaudited Pro Forma Financial Information is not necessarily indicative of the combined financial position or results of operations that would have been realized had the merger occurred as of the dates indicated, nor is it meant to be indicative of any anticipated combined financial position or future results of operations that the BAT Group will experience after the completion of the merger. The actual financial position and results of operations will differ, potentially significantly, from the pro forma amounts reflected herein due to a variety of factors, including access to additional information, changes in value not currently identified and changes in operating results following the date of the Unaudited Pro Forma Financial Information. The Unaudited Pro Forma Financial Information does not reflect any adjustment for liabilities or related costs of any integration and similar activities, or benefits, including potential synergies that may be derived in future periods, from the merger.

The Unaudited Pro Forma Financial Information has been developed from and should be read in conjunction with the BAT Group's consolidated financial statements and the related notes thereto, the BAT Group's unaudited condensed consolidated financial statements and the related notes thereto, the RAI Group's consolidated financial statements and the related notes thereto, the RAI Group's unaudited condensed consolidated financial statements and the related notes thereto and the Unaudited Pro Forma Financial Information and the related notes thereto, included in this Offering Memorandum.

Summary BAT Unaudited Pro Forma Condensed Combined Income Statement Data

	For the Six Months Ended June 30, 2017	For the Year Ended December 31, 2016
	(in £ millions)	
Revenue	12,638	23,796
Profit from operations	4,781	11,590
Profit for the year	2,976	21,325
Profit attributable to owners of the parent	2,890	21,134
Earnings per share attributable to BAT shareholders		
Basic (pence)	126.1	922.1
Diluted (pence)	125.7	918.1
Weighted average shares outstanding, in millions		
Basic	2,292	2,292
Diluted	2,300	2,302

Summary BAT Unaudited Pro Forma Condensed Combined Balance Sheet Data

	As of June 30, 2017
	(in £ millions)
Total assets	145,039
Total current liabilities	18,613
Total borrowings	51,231
Share capital	615
Total equity	53,602
Equity attributable to the owners of the parent	53,410
Total liabilities and equity	145,039

RISK FACTORS

The following factors may affect our ability to fulfill our obligations under the Notes. Most of these factors are contingencies which may or may not occur and the BAT Group is not in a position to express a view on the likelihood of any such contingency occurring. In addition, factors which could be material for the purpose of assessing the market risks associated with the Notes are also described below. We believe that the factors described below represent the principal risks inherent in investing in the Notes. Prospective purchasers of the Notes offered hereby should note that our inability to pay interest, principal or other amounts on or in connection with any Notes may occur for reasons other than those stated below and we do not represent that such statements below regarding the risks of holding any Notes are exhaustive. Prospective purchasers of the Notes should also read the detailed information set out elsewhere in this Offering Memorandum and reach their own views prior to making any investment decisions. Purchasers may lose the value of their entire investment in certain circumstances.

Risk Factors Relating to the BAT Group and the Tobacco Industry

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

Illicit trade and tobacco trafficking in the form of counterfeit products, smuggled genuine products and locally manufactured products on which applicable taxes are evaded, represent a significant and growing threat to the legitimate tobacco industry. For example, it is estimated by Euromonitor International that the illicit market for cigarettes accounted for approximately 11% of total sales, excluding China, in 2016. Factors such as increasing levels of taxation, price increases, lack of law enforcement, weak border control, regulatory restrictions such as plain packaging or graphic health warnings, display bans, taste or ingredient restrictions and economic downturn are encouraging more adult tobacco consumers to switch to illegal cheaper tobacco products and providing greater rewards for counterfeiters and smugglers. Illicit trade can have an adverse effect on the BAT Group's overall sales volume and profits, restrict the ability to increase selling prices and damage brand equity, which in turn could lead to a competitive disadvantage. Illicit trade can also potentially damage the BAT Group's reputation, undermine the BAT Group's investment in trade marketing and distribution, negatively impact the BAT Group's brand image and may lead to commoditization of its products. This could have an adverse effect on the BAT Group's business, results of operations and financial conditions.

The BAT Group's business faces increasing tobacco control and regulation which may have an impact on its overall sales volume and profit.

The advertising, sale and consumption of tobacco products have been, and continue to be, subject to increasingly stringent regulatory regimes. These restrictions have been introduced by both regulation and voluntary agreements and may impact the BAT Group's ability to sell its existing products, maintain or build brand equity, communicate with adult tobacco consumers, apply strategic pricing decisions, launch future products and innovations, enter new markets, including through acquisitions, and compete within the legitimate tobacco industry; may impact adult tobacco consumers' ability to differentiate products; may reduce adult tobacco consumer acceptability of new product specifications; and, in particular, may contribute to the growth of illicit tobacco products. This may have an adverse effect on the BAT Group's business, results of operations and financial conditions.

Increased scope and severity of compliance regimes introduced by new regulation could lead to higher costs and greater complexity, and potential reputational damage, product recall, regulatory sanctions or fines in connection with inadvertent breach.

Taking into account the significant number of regulations that may apply to the BAT Group's businesses across the world, the BAT Group is and may in the future be subject to claims for breach of such regulations. Even when proven untrue, there are often financial costs and reputational impacts in defending against such claims, in particular, considering the speed and spread of any accusations through social media. See "*Business — Regulation*".

Most regulation or potential regulatory initiatives can typically be categorized as follows:

- *Place*: including regulations restricting smoking in private, public and work places (e.g., public place smoking bans);
- *Product*: including regulations on the use of ingredients, product design and attributes (e.g., ceilings regarding tar, nicotine and carbon monoxide yields, as well as restrictions on flavors); product safety regulations (e.g., General Product Safety Directive (2001/95/EC), electrical safety regulations and reduced cigarette ignition propensity standards) and regulatory product disclosure requirements (e.g., in relation to ingredients and emissions);

- *Packaging and labeling*: including regulations on health warnings and other government-mandated messages (e.g., in respect of content, positioning, size and rotation); restrictions on the use of certain descriptors and brand names; requirements on pack shape, size, weight and color and mandatory plain packaging;
- *Sponsorship, promotion and advertising*: including partial or total bans on tobacco advertising, marketing, promotions and sponsorship and restrictions on brand sharing and stretching (the latter refers to the creation of an association between a tobacco product and a non-tobacco product by the use of tobacco branding on the non-tobacco product);
- *Purchase*: including regulations on the manner in which tobacco products are sold, such as type of outlet (e.g., supermarkets and vending machines) and how they are sold (e.g., above the counter versus beneath the counter); and
- *Price*: including regulations which have implications on the prices which manufacturers can charge for their tobacco products (e.g., excise and minimum prices).

The BAT Group believes that further tobacco-control regulation is inevitable over the medium term in most of the BAT Group's markets, and is driven by tobacco control activities undertaken by national governments and non-governmental organizations, as well as guidelines and protocols derived from the World Health Organization's Framework Convention on Tobacco Control, referred to as the FCTC. The FCTC is an international public health treaty, ratified by 180 governments worldwide, that establishes a global program to promote the regulation of tobacco in an effort to reduce initiation and encourage cessation.

The FCTC has led to increased efforts by tobacco control advocates and public health organizations to reduce the supply of and demand for tobacco products, and to encourage governments to further regulate the tobacco industry. Many of the measures outlined in the FCTC have been or are being implemented by means of national legislation in many markets in which the BAT Group operates.

In recent years, some countries have moved beyond the recommendations of the FCTC. For example, the adoption of the Tobacco Plain Packaging Act 2011 in Australia has required the use of plain packaging in Australia since December 1, 2012. Also, the EU has adopted the revised Tobacco and Related Products Directive (Directive 2014/40/EU), referred to as TPD2. Among other things, this directive bans the sale of tobacco products with a characterizing flavor. Menthol-flavored cigarettes are exempt from the ban until May 2020. TPD2 also purports to leave open to EU member states the possibility of further standardizing the packaging of tobacco products and to apply its provisions in different ways. For example, it provides, among other things, that the labeling, packaging and the tobacco product itself shall not include any element or feature that suggests that a particular tobacco product has vitalizing, energetic, healing, rejuvenating, natural, organic properties or has other health or lifestyle benefits. On February 1, 2017, the French Government applied its laws transposing these provisions into French national law to prohibit the sale of all variants of Vogue cigarettes from February 2018, as well as the use of certain other tobacco brand and brand variant names.

More recently, significant debate has been generated regarding the appropriate regulation of next generation products. This includes debate over the nicotine-containing liquids used in vapor products, and the classification of products and restrictions on advertising. A consensus framework for regulating and taxing such products has yet to emerge.

Significant and/or unexpected increases or structural changes in tobacco-related taxes have been proposed or enacted and are likely to continue to be proposed or enacted in numerous jurisdictions. These changes may result in a decline in overall sales volume for the BAT Group's products or may alter its sales mix.

Tobacco products are subject to high levels of taxation, including excise taxes, sales taxes, import duties and levies in most markets in which the BAT Group operates. In many of these markets, taxes are generally increasing but the rate of increase varies between markets and between different types of tobacco products. Increases in tobacco excise taxes may be caused by a number of factors, including fiscal pressures, health policy objectives and increased lobbying pressure from anti-tobacco advocates. Significant or unexpected increases in tobacco taxes, the introduction of laws establishing minimum retail selling prices, changes in relative tax rates for different tobacco products or adjustments to excise structures, have and may continue to result in an increase in illicit trade, a decline in overall sales volume for the BAT Group's products or an alteration in the sales mix in favor of value-for-money brands and may have an adverse effect on the BAT Group's business, results of operations and financial conditions. Increases in tobacco-related taxes, the introduction of new tobacco-related taxes or changes to excise structures can limit the BAT Group's ability to increase the prices on tobacco products or could necessitate absorption of tax increases. Additionally, tax increases can also lead to portfolio erosion, reduction of legal industry sales volumes and growth in illicit trade.

The BAT Group faces significant tobacco-related and other litigation that could substantially reduce profitability and could severely impair liquidity.

There are a number of legal and regulatory actions, proceedings and claims against the BAT Group related to tobacco products pending in a number of jurisdictions, including the United States and Canada. These proceedings comprise claims for personal injury (both individual claims and class actions), economic loss arising from the treatment of smoking and health-related diseases (such as medical recoupment claims brought by local governments), negligence, strict liability in tort, design defect, failure to warn, fraud, misrepresentation, deceptive and unfair trade practices, conspiracy, medical monitoring, and violations of antitrust and racketeering laws. There are also ongoing proceedings that are not directly related to tobacco products, including environmental pollution claims. These various proceedings could give rise to material liability.

Tobacco-related litigation

Tobacco-related litigation falls into three broad categories: medical reimbursement cases; class actions and individual cases.

In the United States, B&W is a defendant in a number of product liability cases. The total number of U.S. tobacco product liability cases pending as of June 30, 2017 involving B&W was approximately 4,728 (compared to approximately 4,925 as of December 31, 2016). 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 totaling billions of U.S. dollars.

Although B&W has the benefit of an indemnity from RJR Tobacco Company, a subsidiary of RAI, with respect to all of the 4,728 cases involving B&W, this indemnity is now, after the completion of the merger, between members of the BAT Group, and as such the BAT Group does not benefit from an indemnification by an external party.

As of June 30, 2017, active product liability claims against the BAT Group companies existed in 14 markets outside the United States. The only markets with more than five claims were Argentina, Brazil, Canada, Chile, Italy and Nigeria. In Canada, following the implementation of legislation enabling provincial governments to recover healthcare costs directly from tobacco manufacturers, ten actions for recovery of healthcare costs arising from the treatment of smoking and health-related diseases have been brought and are proceeding in ten provinces. Damages sought have not yet been quantified by all ten provinces; however, in respect of five provinces, the damages quantified in each of the provinces range between Cdn$25-118 billion. Legislation in two of the three territories has received the Royal Assent but is not yet in force. As of June 30, 2017, medical reimbursement actions had been brought in Angola, Argentina, Brazil, Canada, Nigeria and South Korea, and class actions had been brought in Brazil, Italy, Venezuela and Canada, with 11 class actions in Canada spread over seven provinces.

On June 30, 2017, there were 249 cases pending against the Reynolds Defendants (defined herein): 232 in the United States and 17 in Canada (not including the approximately 564 individual smoker cases pending in West Virginia state court as a consolidated action, 2,694 *Engle* Progeny cases, involving approximately 3,492 individual plaintiffs, and 2,346 *Broin II* cases pending in the U.S.).

The tobacco-related legal actions range from individual lawsuits to class-actions and other aggregate claim lawsuits. For example, in *Engle v. R. J. Reynolds Tobacco Co.*, involving RJR Tobacco Company and B&W, the Florida Supreme Court issued a ruling that, while determining that the case could not proceed further as a class action, permitted members of the *Engle* class to file individual claims, including claims for punitive damages, through January 11, 2008. The decision preserved several of the *Engle* jury findings for use in adjudicating these subsequent individual actions, which are now known as *Engle* Progeny cases. As of June 30, 2017 RJR Tobacco Company had been served in 2,694 pending *Engle* Progeny cases filed on behalf of approximately 3,492 individual plaintiffs. Many of these are in active discovery or nearing trial. In all *Engle* Progeny cases tried to date, a central issue has been the proper use of the preserved *Engle* findings. RJR Tobacco Company has argued that the use of the *Engle* findings to establish individual elements of claims (such as defect, negligence and concealment) is a violation of federal due process. In 2013, both the Florida Supreme Court and the U.S. Court of Appeals for the Eleventh Circuit rejected that argument. In *Hess v. Philip Morris USA Inc.* and *Russo v. Philip Morris USA Inc.*, decided on April 2, 2015, the Florida Supreme Court held that, in *Engle* Progeny cases, the defendants cannot raise a statute of repose defense to claims for concealment or conspiracy. On April 8, 2015, in *Graham v. R. J. Reynolds Tobacco Co.*, the Eleventh Circuit held that federal law impliedly preempts use of the preserved *Engle* findings to establish claims for strict liability or negligence. On January 21, 2016, the Eleventh Circuit granted the plaintiff's motion for rehearing *en banc* and vacated the panel decision. On May 18, 2017, the *en banc* Eleventh Circuit rejected RJR Tobacco Company's due process and implied preemption arguments. The

Engle Progeny cases have resulted in increased litigation and trial activity, including an increased number of adverse verdicts, and increased expenses. Since the beginning of 2014 through June 30, 2017, RJR Tobacco Company or Lorillard Tobacco has paid judgments in 39 *Engle* Progeny cases and have cumulatively paid $246.3 million in compensatory or punitive damages and $97.8 million for attorneys' fees and statutory interest, for a total of $344.1 million, in these cases. In addition, outstanding jury verdicts in favor of the *Engle* Progeny plaintiffs had been entered against RJR Tobacco Company or Lorillard Tobacco for $202.7 million in compensatory damages (as adjusted) and $224.9 million in punitive damages, a total of $427.6 million, as of June 30, 2017. All of these verdicts are in various stages in the appellate process and have been bonded as required by Florida law under the $200 million bond cap passed by the Florida legislature in 2009. Although RJR Tobacco Company cannot currently predict when or how much it may be required to bond and pay, RJR Tobacco Company will likely be required to bond and pay additional judgments as the litigation proceeds.

Class-action suits have been filed in a number of states against individual cigarette manufacturers, including B&W, RJR Tobacco Company and RAI, alleging that the use of the terms "lights" and "ultra-lights" constitutes unfair and deceptive trade practices. In addition, several class actions have been filed against SFNTC and RAI asserting that use of the terms "natural", "additive-free" and "organic" in the product labeling and advertising for SFNTC's Natural American Spirit cigarette brand violates state disclosure, and deceptive and unfair trade practice, statutes.

Furthermore, the BAT Group is subject to substantial payment obligations under the MSA and the state settlement agreements with the states of Mississippi, Florida, Texas and Minnesota (the MSA and such settlement agreements, collectively "State Settlement Agreements"). RAI's operating subsidiaries' expenses and payments under the State Settlement Agreements for 2016 amounted to $2,727 million in respect of settlement expenses and $3,042 million in respect of settlement cash payments. RAI's operating subsidiaries' projected expenses and payments under the State Settlement Agreements for 2017 and 2018, and thereafter, amount to greater than $3,000 million per year in respect of projected settlement expenses and, in respect of projected settlement cash payments, greater than $2,700 million in respect of 2017 and greater than $3,000 million per year in respect of 2018 and thereafter.

It is likely that legal actions, proceedings and claims arising out of the sale, distribution, manufacture, development, advertising, marketing and claimed health effects of cigarettes and other tobacco products will continue to be filed against the BAT Group and other tobacco companies for the foreseeable future.

Judgments in favor of plaintiffs in highly publicized cases against members of the BAT Group and other tobacco companies regarding the health effects of smoking may stimulate further claims. A material increase in the number of pending claims could significantly increase defense costs. In addition, adverse outcomes in pending cases could have adverse effects on the ability of the BAT Group to prevail in other smoking and health litigation.

Non-tobacco-related litigation

There are also a number of non-tobacco-related legal and regulatory proceedings against the BAT Group. For example, one of the BAT's subsidiaries has certain liabilities in respect of indemnities given on the purchase and disposal of former businesses in the United States, which has resulted in the BAT Group subsidiary entering into an arrangement with certain parties to fund a portion of the ongoing costs of the clean-up of environmental contamination in the Fox River. The sums the BAT Group subsidiary has agreed to pay under the Funding Agreement are subject to ongoing adjustment, as clean-up costs can only be estimated in advance of the work being carried out and as certain sums payable are the subject of ongoing U.S. litigation. In 2016, the BAT subsidiary paid £6 million in respect of clean-up costs and is potentially liable for a further £159 million in future clean-up costs. Such BAT subsidiary may also be liable under the indemnities in respect of claims in relation to the environmental clean-up of the Kalamazoo River. The amount of the clean-up costs for the Kalamazoo River is presently unclear, but could run into hundreds of millions of dollars. Non-tobacco-related litigation, including for natural resource damages which costs cannot be estimated at this time, could impose substantial monetary obligations on the BAT Group and could have an adverse effect on the results of operations, cash flows and financial position of the BAT Group.

General litigation conclusion

The BAT Group's consolidated results of operations, cash flows and financial position could be materially affected in a particular fiscal quarter or fiscal year by an unfavorable outcome of certain pending or future litigation, including through exposure to substantial liabilities as a result of such outcomes. This, in turn, could materially increase costs, including costs associated with bringing proceedings and defending such claims, which includes exposure to adverse costs orders. Any negative publicity resulting from these claims may adversely affect the BAT Group's reputation.

See "*Business of BAT — Regulation*", "*Business of BAT — Business — Legal Proceedings*", "*Business of RAI — Legal Proceedings*", note 28 to the BAT Group's 2016 consolidated financial statements , note 30 to the BAT Group's 2015 consolidated financial statements and note 13 to the RAI Group's consolidated financial statements included in this Offering Memorandum.

The BAT Group is exposed to economic, regulatory and political factors inherent in its global operations.

The BAT Group operates in over 200 markets. The BAT Group's results of operations and financial condition are influenced by the economic, regulatory and political situations in the markets and regions in which it has operations, which are often unpredictable and outside of its control. In particular, a substantial majority of the BAT Group's profit from operations is based on its operations in 15 markets, and, following the merger, the U.S. The BAT Group's reported profits may be adversely affected by a significant downturn in one or more of these larger markets.

Economic, regulatory and political factors affecting the BAT Group include the prevailing economic climate, governmental austerity measures, levels of employment, inflation, governmental action to increase minimum wages, employment costs, interest rates, raw material costs and consumer confidence. Any change to such factors in any of the markets in which the BAT Group operates could affect consumer behavior and have an impact on its revenue, margins and cash flow.

Additionally, some markets in which the BAT Group operates face the threat of increasing civil unrest and can be subject to frequent changes in regime. In others, terrorism, conflict, the threat of war or criminal activity, or economic policy changes, such as state nationalization of assets and withdrawal from international or bilateral trade agreements, may have a significant impact on the business environment. National and international sanction regimes may also affect jurisdictions where the BAT Group operates or third parties with whom it may have commercial relationships and could lead to supply and payment chain disruptions. In addition, some markets maintain trade barriers or adopt policies that favor domestic producers, preventing or restricting the BAT Group's sales.

Certain of these risks may disrupt the BAT Group's supply chain, manufacturing capabilities or distribution capabilities, resulting in the loss of personnel, property or equipment that are critical to its business in certain markets and difficulty in staffing and managing its operations, which could in turn reduce the BAT Group's volumes, revenues and net earnings. The BAT Group may also face increased costs due to the need for more complex supply chain arrangements and to build new facilities or to maintain inefficient facilities as a result of these risks.

Completion of the merger resulted in the BAT Group becoming subject to U.S. regulations which are different from the regulations to which the BAT Group was subject before completion of the merger. Current and future U.S. regulations could have an adverse effect on the results of operations, cash flows and financial position of the BAT Group.

Following completion of the merger, the BAT Group's exposure to the impact of a wide variety of U.S. federal, state and local laws has increased. Any such existing or future additional regulations will pose an increased compliance burden for the BAT Group and, particularly where supplemented by new regulations, this could lead to higher costs and greater complexity, and potential reputational damage, product recall, regulatory sanctions or fines in connection with inadvertent breach. The enactment of unduly onerous and restrictive regulation could have a material adverse effect on the results of operations, cash flows and financial position of the BAT Group.

These regulations include limitations on the advertising, sale and/or use of tobacco products in the United States, which have proliferated in recent years. For example, some local laws prohibit the sale of certain tobacco products, prohibit certain types of marketing practices, such as consumer coupons, or prohibit the consumption of cigarettes and other tobacco products in restaurants and other public places. Private businesses also have adopted policies that prohibit or restrict, or are intended to discourage, smoking and tobacco use. Among other things, these laws, regulations and policies could result in a decline in the overall sales volume of tobacco products in the United States, which could have an adverse effect on the results of operations, cash flows and financial position of BAT and its operating subsidiaries following the merger.

The BAT Group is now subject to, among others, the following U.S. laws and regulations:

U.S. securities, corporate governance and compliance laws and regulations

As a result of the registration of the BAT ordinary shares with the SEC in connection with the merger and the listing of its ADSs on the NYSE, BAT is now subject to U.S. securities laws and other U.S. laws and regulations, including the U.S. Foreign Corrupt Practices Act of 1977, which now applies to the BAT Group's worldwide activities and the Sarbanes-Oxley Act of 2002 as a foreign private issuer (as defined in Rule 3b-4(c) of the Exchange Act and Rule 405 of the Securities Act). These regulations are different from the regulations to which BAT was subject to prior to the merger, and therefore pose an increased compliance burden on BAT. While BAT continuously seeks to improve its systems of internal controls and to remedy any weaknesses identified, there can be no assurance that the policies and procedures will be followed at all times or effectively detect and prevent violations of applicable laws.

FDA regulations

The FDA has broad authority over the manufacture, sale, marketing and packaging of tobacco products. Regulations issued by the FDA could, among other impacts, result in a decrease in cigarette and smokeless tobacco product sales in the United States, including sales of the BAT Group's brands, has resulted in increased costs for the historical RAI Group and may increase the costs of operations of the BAT Group.

For example, the ability of the BAT Group to introduce new tobacco products in the United States could be adversely affected by FDA rules and regulations. Under the FDA Tobacco Act, for a manufacturer to launch a new tobacco product or modify an existing tobacco product after March 22, 2011, the manufacturer must obtain an order from the FDA's Center for Tobacco Products (the "CTP"), allowing the new or modified product to be marketed. Similarly, a manufacturer that introduced a product between February 15, 2007 and March 22, 2011, was required to file a substantial equivalence report with the CTP demonstrating either (1) that the new or modified product had the same characteristics as a product commercially available as at February 15, 2007, referred to as a predicate product, or (2) if the new or modified product had different characteristics than the predicate product, that it did not raise different questions of public health. A product subject to such report is referred to as a provisional product. A manufacturer may continue to market a provisional product unless and until the CTP issues an order that the provisional product is not substantially equivalent ("NSE"), in which case the FDA could then require the manufacturer to remove the provisional product from the market. On September 15, 2015, the CTP issued four NSE orders to RJR Tobacco Company, determining that four cigarette styles were not substantially equivalent to their respective predicate products, and ordering that RJR Tobacco Company immediately stop all distribution, importation, sale, marketing and promotion of these provisional products. RJR Tobacco Company has complied with these NSE orders. Although the sales of the provisional products subject to the foregoing NSE orders are not material to RJR Tobacco Company, substantially all of the RAI Group's products currently on the market are provisional products. If the CTP were to issue NSE orders with respect to other provisional products of the RAI Group such orders, if not withdrawn or invalidated, would have an adverse impact on the sales of the products subject to the orders, and could have an adverse impact on the results of operations, cash flows and financial position of the BAT Group.

On August 27, 2015 the FDA sent a warning letter to the RAI Group operating subsidiary SFNTC, claiming that SFNTC's use of the terms "Natural" and "Additive Free" in the product labeling and advertising for Natural American Spirit cigarettes violates the FDA Tobacco Act. Pursuant to an agreement entered into with the FDA, SFNTC has committed to phasing out use of the terms "Natural" and "Additive Free" from product labeling and advertising for Natural American Spirit cigarettes on an established timeframe. While SFNTC may continue to use the term "Natural" in the Natural American Spirit brand name and trademarks, SFNTC's scheduled deletion of the terms "Natural" and "Additive Free" from the labeling and advertising of its Natural American Spirit cigarettes could have an adverse effect on the sale of such cigarettes and, as a result, on the results of operations, cash flows and financial position of the BAT Group.

Further, the FDA may seek to require the reduction of nicotine levels under the FDA Tobacco Act and also may require the reduction or elimination of other constituents. For instance, the FDA has proposed a rule that, if adopted, would require the reduction, over a three-year period, of the levels of N-nitrosonornicotine ("NNN") contained in smokeless tobacco products. The adoption of this proposed rule is currently suspended by virtue of a federal regulatory freeze imposed by the U.S. President. It is not known whether or when this proposed rule will be adopted, and, if adopted, whether the final rule will be the same as or similar to the proposed rule. In addition, on July 28, 2017, the FDA announced its intention to issue an Advance Notice of Proposed Rulemaking ("ANPRM") to seek input on the potential public health benefits and any possible adverse effects of lowering nicotine in combustible cigarettes to 'non-addictive' levels.

If the proposed rule on NNN reduction (either in its current form or in a form substantially similar to its current form) or other rules on nicotine reduction are adopted, compliance or the inability to comply could have an adverse effect on the results of operations, cash flows and financial position of the BAT Group.

FDA regulations in relation to next generation products

The FDA may also issue other regulations that, among other things, make it more difficult for the BAT Group to grow its e-cigarette business in the United States or that limit the level of nicotine in cigarettes made, sold or marketed in the United States. On May 10, 2016, the FDA issued, what was expected to be, a final regulation deeming e-cigarettes and certain other tobacco products to be subject to the FDA's regulatory authority under the FDA Tobacco Act. As a result, such newly 'deemed' tobacco products will be subject to many of the same requirements of the FDA Tobacco Act that currently apply to cigarettes and smokeless tobacco products. Under this 'final' regulation, any newly 'deemed' tobacco products, including e-cigarettes that were not on the market as at February 15, 2007 would have been considered a new tobacco product subject to premarket review by the FDA. Neither RJR Vapor's VUSE e-cigarette, nor virtually any other e-cigarette, was on the market as at such date. As a result, e-cigarette manufacturers, including RJR Vapor and the BAT Group would not have been able to utilize the substantial equivalence pathway for clearing these products, but instead would have had to file premarket tobacco product applications by August 8, 2018 (later extended to November 8, 2018).

However, on July 28, 2017, the FDA announced its intention to extend the deadline for filing these applications until August 8, 2021 for combustible products and until August 8, 2022 for non-combustible products. The FDA also re-confirmed that a manufacturer that files a premarket application for such a product before the relevant deadline may continue to market the product for a certain period of time pending the FDA's review of the application. For products that were not in the market by August 8, 2016, manufacturers must file and await clearance of such premarket applications before placing such products into commerce.

For the FDA to clear a premarket tobacco product application covering an e-cigarette, the applicant must show that the marketing of the e-cigarette would be appropriate for the protection of the public health. Despite the FDA announcement on July 28, 2017 that it plans to issue foundational rules to make the application and product review process more efficient, predictable and transparent for manufacturers, at present, there remains substantial uncertainty over how the FDA will interpret that standard when determining whether to clear an e-cigarette premarket tobacco application. If the BAT Group is unable to obtain FDA clearance, or obtains FDA clearance on a delayed basis, of premarket applications for VUSE and other e-cigarette products, then there could be an adverse effect on the results of operations, cash flows, and financial position of the BAT Group.

Regulations banning or materially restricting the use of menthol in tobacco products

As a result of the merger, BAT, through its subsidiaries, acquired RJR Tobacco Company's Newport brand, and other menthol brands, which represent a substantial portion of RAI's total consolidated net sales. The RAI Group estimates that approximately 50% of its total consolidated net sales were attributable to menthol cigarettes for the year ended December 31, 2016. The FDA may adopt regulations banning or severely restricting the use of menthol in tobacco products or the sale of menthol cigarettes. As part of its announcement on July 28, 2017, the FDA confirmed that it would issue an ANPRM to seek public comment on the role that flavors (including menthol) in tobacco products play in attracting youth and may play in helping some smokers switch to potentially less harmful forms of nicotine delivery. See *"BAT, through its subsidiaries, has acquired RJR Tobacco Company's Newport brand, the leading U.S. menthol cigarette brand, and any action by the FDA or any other governmental authority that could have the effect of banning or materially restricting the use of menthol in tobacco products could have a material adverse effect on sales of the Newport brand and the menthol styles of other brands of RAI's operating subsidiaries, which could have an adverse effect on the results of operations, cash flows and financial position of the BAT Group"*.

Advertising and marketing of tobacco products

The BAT Group is subject to significant limitations on the advertising and marketing of tobacco products in the United States. Additional such regulation could harm the value of the BAT Group's existing brands and ability to launch new brands. In the United States, television and radio advertisements of cigarettes have been prohibited since 1971, and television and radio advertisements of smokeless tobacco products have been prohibited since 1986. Under the master settlement agreement dated November 23, 1998 between 46 U.S. states, the District of Columbia and five U.S. territories and various tobacco manufacturers, including RJR Tobacco Company, B&W and Lorillard Tobacco, resolving various state healthcare cost recovery claims, RJR Tobacco Company and SFNTC, as a subsequent participating manufacturer under the MSA, cannot use billboard

advertising, cartoon characters, sponsorship of certain events, non-tobacco merchandise bearing their brand names and various other advertising and marketing techniques. The MSA also prohibits targeting of youth in advertising, promotion or marketing of tobacco products, including the smokeless tobacco products of RJR Tobacco Company. In addition, pursuant to the FDA Tobacco Act, the FDA has reissued regulations addressing advertising and marketing restrictions that were originally promulgated in 1996. Although these restrictions were intended to ensure that tobacco advertising was not aimed at young people, some of the restrictions also may limit the ability of the BAT Group to communicate with adult tobacco consumers in the United States.

Any additional regulations issued by the FDA or any additional U.S. federal, state or local laws could have a material adverse effect on the results of operations, cash flows and financial position of the BAT Group.

The BAT Group's inability to obtain price increases may adversely affect its sales and growth.

Annual manufacturers' price increases are among the key drivers in increasing market profitability. However, the BAT Group may not be able to obtain such price increases as a result of increased regulation, which may reduce its ability to build brand equity and enhance its value proposition to its adult tobacco consumers; stretched consumer affordability arising from deteriorating economic conditions and rising prices; sharp increases or changes in excise structures; and competitor pricing activities. As a result, the BAT Group may be unable to achieve its strategic growth metrics, have fewer funds to invest in growth opportunities, and be faced with quicker reductions in sales volumes than anticipated due to accelerated market decline. In addition, down-trading (switching to a cheaper brand) and illicit trade may increase. These in turn may impact the BAT Group's business, results of operations and financial conditions.

The BAT Group's business may be significantly impacted by constantly changing tax rates from around the world as well as unfavorable rulings in relation to tax disputes.

The BAT Group operates in over 200 markets and pays tax in accordance with the tax legislation of those markets. Tax laws and tax rates around the world frequently change on a prospective or retroactive basis and these changes may have a significant impact on the taxes the BAT Group must pay and may impact its net profits, which could be material.

Further, taking into account the frequent changes to tax regulations, it is possible that the BAT Group may be subject to claims for breach of such regulations, including for late or incorrect filings or for misinterpretation of rules. The BAT Group is party to tax disputes in a number of jurisdictions, including Brazil, South Africa, The Netherlands and Bangladesh. For example, in Brazil, the tax authority is seeking to reassess the profits of overseas subsidiaries to corporate income tax and social contribution tax. The reassessments are for the years 2004 until and including 2012 for a total amount of BRL1,386 million (£345 million) to cover tax, interest and penalties. In South Africa, debt financing is being challenged across the periods from 2006 to 2010 for a total amount of ZAR1.92 billion (£112 million) covering both tax and interest. In The Netherlands, the Dutch tax authority has issued assessments for the years 2008, 2009, 2011 and 2012 in the sum of €202 million (£172 million) to cover tax, interest and penalties. The assessments relate to a number of intra-group transactions. In Bangladesh, the tax authority issued a retrospective notice of imposition and realization of VAT and supplementary duty on low price category brands from the National Board of Revenue for approximately £186 million.

The BAT Group may face significant financial penalties, including the payment of fines and interest in the event of an unfavorable ruling by a tax authority in a disputed area. The impact could affect the BAT Group's profit and dividend and cause a disruption and loss of focus on the business due to the diversion of management time. See note 28 to the BAT Group's 2016 consolidated financial statements and note 30 to the BAT Group's 2015 consolidated financial statements included in this Offering Memorandum.

The BAT Group's business is vulnerable to the effects of a tough trading environment and declining consumption of legitimate tobacco products.

The BAT Group competes primarily on the basis of product quality, brand recognition, brand loyalty, taste, innovation, packaging, service, marketing, advertising and price. The BAT Group is subject to highly competitive conditions in all aspects of its business. The competitive environment and the BAT Group's competitive position can be significantly influenced by the prevailing economic climate, consumers' disposable income, regulation, competitors' introduction of lower-price products or innovative products, higher tobacco product taxes, higher absolute prices, governmental action to increase minimum wages, employment costs, interest rates and increase in raw material costs. Furthermore, the BAT Group is subject to substantial payment obligations under the State Settlement Agreements, which adversely affect the ability of the BAT Group to compete in the United States with manufacturers of deep-discount cigarettes that are not subject to such substantial obligations.

In tough competitive environments, where the price burden on adult tobacco consumers is high, the BAT Group's ability to raise prices could be limited. In addition, the BAT Group may be vulnerable to market size reduction, customer down-trading (including to fine cut), illicit trade and competitors aggressively taking market share through price repositioning or price wars, which generally has the impact of reducing the overall profit pool of the market and therefore the BAT Group's profits, as well as lead to a decline in the sales volumes of the BAT Group, erosion of its portfolio mix and reduction of funds available to it for investment in growth opportunities.

The BAT Group's business is further impacted by the continued decline in consumption of tax-paid cigarettes in many of the BAT Group's key markets. Consumption of cigarettes by volume declined industry-wide by approximately 3% in 2016, based on the BAT Group's internal estimates. This decline is due to multiple factors, including the increase in excise taxes and changes in the regulatory environment leading to continued above-inflation price rises, the continuing difficult economic environment in many countries impacting consumers' disposable incomes, and the increase in the trade of illicit tobacco products. Any future substantial decline in the demand for legitimate tobacco products could have an adverse effect on the BAT Group's business, results of operations and financial conditions.

The BAT Group is exposed to foreign exchange rate risk.

The BAT Group's reporting currency is the pound sterling. The BAT Group is exposed to changes in currency rates on the translation of the net assets of overseas subsidiaries into the BAT Group's reporting currency. The BAT Group is also exposed to currency changes from the translation of profits earned in overseas subsidiaries; these exposures are not normally hedged. Exposures also arise from the foreign currency denominated trading transactions undertaken by subsidiaries and dividend flows. These exposures are continuously monitored and where not offset by opposing flows, are hedged according to internal policies. However, hedging of certain currencies might not be possible due to exchange controls or limited currency availability. Volatility and/or increased costs in the BAT Group's business due to transactional foreign exchange rate exposures may adversely affect its financial performance. Significant fluctuations in foreign currency exchange rates could have an adverse impact on the BAT Group's results of operations and financial conditions.

During periods of exchange rate volatility, the impact on the BAT Group's results can be significant. Fluctuations in the foreign exchange rate of key currencies against the pound sterling may result in volatility in the BAT Group's reported earnings per share, cash flow and balance sheet. Furthermore, the dividend paid by the BAT Group may be impacted if the payout ratio is not adjusted. Differences in translation between earnings and net debt may also affect key ratios used by credit rating agencies.

The BAT Group may be required to incur significant costs to address breaches of or liabilities arising under, health and safety and environmental laws of the jurisdictions in which it operates.

If the BAT Group fails to maintain adequate safety standards or to comply with the health and safety laws and regulations to which it is subject, this could result in serious injury, ill health, disability or loss of life to employees, which could in turn lead to fines, penalties and criminal or civil legal liability. This could have a negative impact on the BAT Group's reputation and also result in high staff turnover or difficulties in recruitment if the BAT Group is perceived to have a poor health and safety record. It could further adversely affect its operations and financial condition and the value of its assets.

From time to time, the BAT Group, or third-party suppliers to the BAT Group, have accidents in the workplace which, on occasion, can result in the fatality of an employee, a contractor working on their behalf or a member of the public.

Failure to minimize the impact on the natural environment and the local communities in which the BAT Group conducts its business activities or failure to comply with environmental laws and regulations and operational standards to which the BAT Group is subject could result in an adverse impact on the natural environment where the BAT Group operates and could cause business disruption, reputational damage, consequential losses, the obligation to install or upgrade costly pollution control equipment, potentially significant remedial costs and damages, fines, or civil or criminal legal liability. See "*Business — Environmental Matters*".

The BAT Group is exposed to funding and liquidity, interest rate and counterparty risks.

Funding and liquidity risks expose the BAT Group to shortages of cash and cash equivalents needed in its operations and for refinancing its existing debt. The BAT Group cannot be certain that it will have access to bank financing or to the debt and equity capital markets at all times. Some markets in which the BAT Group operates are subject to currency controls and other limitations on currency convertibility which can affect the ability to

pay for imports as well as impede dividend remittances and similar payments, and access to cash balances. Failure to access funding and foreign exchange may have an adverse effect on the BAT Group's funding and liquidity position, the BAT Group's credit rating or its ability to finance strategic opportunities, which would in turn result in increased funding costs for the BAT Group or require the BAT Group to issue equity or seek new sources of capital. The BAT Group may also suffer reputational damage due to its perceived failure to manage the financial risk profile of the business, which may result in an erosion of shareholder value reflected in an underperforming share price.

The BAT Group is subject to restrictive covenants under some of its credit facilities. These covenants could affect the way in which the BAT Group conducts its business, and failure to comply with these covenants could lead to an acceleration of its debt, which may have an adverse impact on its business, results of operations and financial conditions.

The BAT Group maintains both floating and fixed rate debt. Where appropriate, it uses derivatives, primarily interest rate swaps, to vary the fixed to floating mix. Changes in currency values and interest rates could have an adverse impact on the BAT Group's financial condition or operations.

Cash deposits and other financial instruments give rise to credit risk on the amounts due from counterparties. The failure of any counterparty to meet the BAT Group's payment obligations or performance undertakings to it or the deterioration in the financial condition of one or more of its counterparties could have an adverse effect on the BAT Group's financial condition or operations. In addition, the failure of a transactional banking counterparty could cause disruption to the BAT Group's operations. See "*Management's Discussion and Analysis of Financial Condition and Results of Operations of BAT — Quantitative and Qualitative Disclosures about Market Risk*".

The BAT Group may be unsuccessful in launching innovative products that offer adult tobacco consumers meaningful value-added differentiation.

The BAT Group focuses its research and development activities on both creating new products and processes and maintaining and improving the quality of its existing products. In a competitive market, the BAT Group believes that innovation is key to growth. The BAT Group considers that one of its key challenges in the medium and long-term is to provide adult tobacco consumers with high-quality products that take into account their changing preferences and expectations, while complying with evolving regulation. The inability to develop and roll-out innovations or consumer relevant products, including any failure to predict changes in adult tobacco consumer and societal behavior and expectations and fill gaps in the product portfolio, as well as the risk of poor product quality or the BAT Group's inability to timely develop and bring products to market could lead to missed opportunities, under or over-supply, loss of competitive advantage, unrecoverable costs and/or the erosion of its consumer base. The BAT Group's potential failure to predict changes in consumer behavior, to install sufficient manufacturing capacity to meet such new or increased demand or to take appropriate pricing decisions, could have an adverse effect on the BAT Group's operations and results. Moreover, additional product regulation could further reduce the ability to launch or use innovations, as well as differentiate tobacco products as a result of increased restrictions, such as on ingredients and design. In addition, restrictions on packaging and labeling, as well as restrictions on promotion and advertising, could impact the BAT Group's ability to communicate permitted innovations and product differences to adult tobacco consumers, leading to unsuccessful product launches. The occurrence of any of the above described risks could have an adverse effect on the BAT Group's business, financial condition and results of operations.

The BAT Group may be unsuccessful in its attempts to develop and commercialize consumer-appealing next generation products.

The BAT Group devotes considerable resources to the research and development of a next generation of vapor products and non-combustible tobacco products, some of which may have the potential to reduce the risks of smoking-related disease. Given the challenges of achieving adult tobacco consumer, regulatory and scientific acceptance of these products, there is a risk that these investments may incur significant costs without achieving financial success. If the BAT Group does not succeed, but the BAT Group's competitors do, the BAT Group may be at a competitive disadvantage. Furthermore, the regulatory environment impacting non-combustible products, vapor products and other non-tobacco nicotine products, including classification of products for regulatory and excise purposes, is still developing and it cannot be predicted whether regulations will permit the marketing of such next generation products in any given market in the future. Categorization as medicines, for example, and restrictions on advertising could stifle innovation, increase complexity and cost and significantly undermine the commercial viability of these products. Alternatively, categorization of any next generation products as tobacco products could result in the application of onerous regulation, which could also stifle uptake. The BAT Group's

ability to generate future sales is dependent on a number of factors, many of which are beyond its control, including the pricing of competing products, overall demand for its products, changes in adult tobacco consumer preferences, market competition and government regulation. The occurrence of any of the above described risks could have an adverse effect on the BAT Group's business, financial condition and results of operations.

For example, while VUSE, an RJR Vapor e-cigarette product, is currently the number one e-cigarette product sold in convenience/gas stores, sales of closed system products like VUSE continue to decline in comparison to the sale of tanks and liquid nicotine containers typically sold in vapor shops and on-line in the U.S. The future success of VUSE and other RJR Vapor e-cigarette offerings, including VUSE Vibe, will depend on the ability to innovate in an evolving category of alternative tobacco products.

Failure to uphold high standards of corporate behavior could subject the BAT Group to potential liability under sanctions, anti-corruption and other laws and regulations.

The BAT Group expects its employees to uphold a high standard of corporate behavior and is subject to various anti-corruption laws and regulations (referred to as Anti-Corruptions Laws) that generally prohibit its employees, vendors and agents from engaging in certain activities to obtain or retain business or to influence a person working in an official capacity. In addition, national and international sanction regimes may affect jurisdictions where the BAT Group operates or third parties with whom it may have commercial relationships, which could lead to supply chain or payment chain disruption and forced market exits. Failure of the BAT Group to comply with Anti-Corruption Laws or sanctions could result in significant fines and penalties, criminal sanctions against the BAT Group and its officers and employees, prohibitions on the conduct of the BAT Group's business, and damage to the BAT Group's reputation.

Taking into account the significant number of regulations, including sanctions that may apply to the BAT Group's businesses across the world, the BAT Group may be subject to claims for breach of such regulations or for failure to uphold standards of corporate behavior from time to time. Even when proven untrue, there are often financial costs and reputational impacts in defending against such claims, in particular, considering the speed and spread of any accusations through social media.

The BAT Group is investigating, through external legal advisers, allegations of misconduct and is liaising with the UK Serious Fraud Office ("SFO") and other relevant authorities. The BAT board of directors has also created a sub-committee to specifically monitor matters, having regard to the need to ensure active oversight of, and support for, the investigation between BAT board of directors meetings. The BAT Group has been informed that the SFO has now opened a formal investigation into suspicions of corruption in the conduct of business by BAT, its subsidiaries and associated persons. The BAT Group intends to cooperate with that investigation.

In 2016, the BAT Group began a project, which has continued into 2017, to review and further strengthen all aspects of the BAT Group's global compliance procedures. Any actions taken by government authorities or findings of courts in relation to these matters may result in the adverse consequences identified above for the BAT Group.

Reliance on digital and information technology means that a significant disruption, malicious manipulation or cyber-attack could affect the BAT Group's communications and operations.

The BAT Group increasingly relies on information technology systems for its internal communications, controls, reporting and relations with customers and suppliers. Some of these information systems are managed by third-party service providers. A significant disruption due to computer viruses, cyber threats, malicious intrusions, unintended or malicious behavior by employees, contractors or service providers, the lack of infrastructure or application resilience, slow or insufficient disaster recovery service levels or the installation of new systems could affect the BAT Group's communications and operations. Any data, including confidential, personal or other sensitive information stored or transported by IT systems, could be corrupted, lost or disclosed, causing reputational, competitive or operational damage, fraudulent abuse, malicious manipulation or legal liability and result in significant remediation and other costs to the BAT Group. Restoring or recreating such information could be costly, difficult or even impossible. Further, the General Data Protection Regulation (Regulation (EU) 2016/679), coming into effect in Europe in May 2018, will create a range of new compliance obligations, and increase financial penalties for noncompliance significantly.

Loss of key personnel or inability to attract and retain the best global talent could have a negative impact on the BAT Group's operations.

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

In addition, the tobacco industry competes for talent with consumer products and other companies that enjoy greater societal acceptance than a cigarette company. As a result, the BAT Group may be unable to attract and retain the best global talent.

Failure to successfully design, implement and sustain an integrated operating model or to deliver costs savings may reduce profitability.

The BAT Group aims to improve profitability and productivity through supply chain improvements and the implementation of an integrated operating model, including standardization of processes and shared back-office services. The failure to successfully design, implement and sustain the integrated operating model and organizational structure could lead to the failure to realize anticipated benefits, increased costs, disruption to operations, decreased trading performance and reduced market share, which in turn could further reduce profitability and funds available for investment in long-term growth opportunities.

The BAT Group may be unable to achieve growth through successful mergers, acquisitions and joint ventures.

The BAT Group's growth strategy includes a combination of organic growth as well as mergers, acquisitions and joint ventures. The BAT Group may be unable to acquire attractive businesses on favorable terms and may inappropriately value or otherwise fail to capitalize on growth opportunities. The BAT Group may not be able to deliver strategic objectives and revenue improvements from business combinations, successfully integrate the businesses that it acquires or establishes or obtain the appropriate regulatory approvals for such business combinations. Risks from integration of businesses also include the risk that the integration may divert the BAT Group's focus and resources from its other strategic goals. Any of the foregoing risks could result in increased costs, decreased revenues or a loss of opportunities and have a material adverse effect on the BAT Group's business, results of operations and financial conditions.

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

- ITG Brands, LLC, has an uncapped indemnity in connection with the asset purchase agreement related to the Lorillard Divestiture entered into by the RAI Group; and
- three subsidiaries of the RAI Group have granted an uncapped indemnity in favor of JTI International Holding B.V. in connection with a purchase agreement dated September 28, 2015, which completed on January 13, 2016.

The indemnification obligations referred to above are uncapped except with respect to breaches of representations or warranties, or pre-closing covenants (capped indemnifications for pre-closing covenants is in respect of the agreement with ITG Brands, LLC only). Accordingly, these indemnification obligations could be substantial and could adversely affect the BAT Group's results of operations, cash flows and financial position. See "*Management's Discussion and Analysis of Financial Condition and Results of Operations of BAT — Key Factors Affecting Results of Operations — Business Combinations and Acquisitions*".

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

According to the BAT Group's internal estimates, the BAT Group is a market leader in more than 55 countries by volume and is one of a small number of tobacco companies in certain other markets in which it operates. As a result, the BAT Group may be subject to investigation for alleged abuse of its position in markets in which it has significant market share or for alleged collusion with other market participants, which could result in adverse regulatory action by the authorities, including monetary fines and negative publicity.

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

The BAT Group's market position may be affected through the contamination of its products, either by accident or deliberate malicious intent during the supply chain or manufacturing process or may otherwise fail to comply with the BAT Group's quality standards. In these instances, significant costs may be incurred in recalling products from the market or temporarily ceasing production. In addition, adult tobacco consumers may lose confidence in the specific brand affected by the contamination, resulting in a loss of sales volume which may take a long time to recover or may not fully recover, or the BAT Group could be subject to legal action. During this time, the BAT Group's competitors may substantially increase their market share, which would be difficult and costly to regain. Contamination of the BAT Group's products may have an adverse effect on the BAT Group's business, results of operations or financial condition.

The BAT Group may be adversely affected by the performance of its associates.

Although the BAT Group owns an approximate 30% interest in ITC, the BAT Group's associate company in India, it does not have control over ITC. The BAT Group's ownership interest in ITC means the BAT Group may be affected by its business and financial performance, as it is subject to tobacco-related industry and business risk factors similar to those the BAT Group faces. Any issue with the business and financial performance of ITC may have an adverse impact on the business, financial condition and results of operations of the BAT Group.

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

Some of the brands and trademarks under which the BAT Group's products are sold are licensed to it for a fixed period of time in respect of specified markets, such as the right to use the Camel, Winston and Salem brands and trademarks in various markets in Latin America. In the event that the license to use any of such brands and trademarks is terminated or is not renewed after the end of the term of the relevant license, the BAT Group will no longer have the right to use, and to sell products under, such brand(s) and trademark(s) in the relevant markets and this could have an adverse effect on its business, results of operations and financial condition. See "*Business — Intellectual Property*".

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

The BAT Group relies on trademarks, patents, registered designs, copyrights and trade secrets. The brand names under which the BAT Group's products are sold are key assets of its business. Investments over a period of time have led to many of the BAT Group's brands having significant brand equity and a global appeal to adult tobacco consumers, essential to delivering sustainable profit growth into the future. The protection and maintenance of the reputation of these brands is important to the BAT Group's success. In some of the markets in which the BAT Group operates, the risk of intellectual property rights infringement remains high as a result of limitations in judicial protection and/or inadequate enforceability. Any substantial erosion in the value of the BAT Group's brands could have a material adverse effect on the BAT Group's business, results of operations and financial condition. The BAT Group's strategy or its execution may not maintain the value in any of its product brands. In addition, as third-party rights are not always identifiable, it is possible that the BAT Group may be subject to claims for infringement of third-party intellectual property rights, which could result in interim injunctions, product recall and payment of damages. Failure to obtain or maintain adequate protection of intellectual property rights for any reason may adversely affect the BAT Group's business, results of operation and financial conditions. See "*Business of BAT — Intellectual Property*" and "*Business of RAI — Intellectual Property*".

The BAT Group is exposed to availability and price volatility in tobacco leaf and other raw materials.

Raw materials and other inputs, such as leaf, wood pulp and energy, used in the BAT Group's businesses are commodities that are subject to price volatility caused by numerous factors, including weather conditions, growing conditions, climate change, local planting decisions, political influence, market fluctuations and changes in agricultural regulations. The BAT Group purchases more than 500,000 tons of packed leaf each year. The BAT Group's results of operations will, therefore, be exposed to fluctuations in the availability and price of tobacco leaf and other commodities required in the manufacture of cigarettes.

Tobacco production in certain countries is also subject to a variety of controls, including regulation affecting farming and production control programs, as well as competition for land use from other agriculture products. The BAT Group's access to raw materials may be adversely affected by a significant event occurring in one or more major leaf growing areas. Climate instability and diseases causing crop failure may have a negative impact on the BAT Group's business, which may include decreased quantity and/or quality of leaf, increased prices, reallocation of growing areas and factories or supply-chain disruptions. Commodity price, quality and quantity changes beyond the BAT Group's control could affect its profitability and business. Such changes may result in unexpected increases in raw materials and packaging costs for the BAT Group's products. The BAT Group may not be able to increase its prices to offset these increased costs without suffering reduced sales volume and income, or be able to meet increased adult tobacco consumer demand for certain types of tobacco.

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

The BAT Group may lose market share and profit due to the loss of production capacity or key suppliers, distribution interruption, commodity risk, problems with labor relations, or a major fire, violent weather conditions or other disasters.

There are some product categories for which the BAT Group does not have spare production capacity or where substitution between different production plants is very difficult. A major fire, violent weather conditions or other disasters that affect manufacturing and other facilities of the BAT Group's operating subsidiaries, or of their suppliers and vendors, could have a material adverse effect on the operations of the BAT Group's operating subsidiaries. For example, RJR Tobacco Company's cigarette manufacturing is conducted primarily at a single facility, and SFNTC's cigarette manufacturing is conducted at a single facility. The BAT Group may lose market share and profit in the event of loss of or insufficient production capacity needed to supply its products or meet increased demand. The BAT Group has an increasingly global approach to managing its supply chain. Severe disruption to any aspect of the BAT Group's supply chain or suppliers' operations or deterioration in the financial condition of a trading partner could have an adverse impact on the BAT Group's ability to produce and deliver products meeting customer demands. For example, the RAI Group relies on a limited number of suppliers for raw materials. If a supplier fails to meet any of RAI's operating subsidiaries demands for raw materials, any such operating subsidiary may fail to operate effectively and may fail to meet shipment demand, which could have an adverse effect on the results of operations, cash flows and financial conditions of the BAT Group. A continuing industry consolidation among distributors and suppliers could lead to reduced efficiency, higher costs and concentrated risk of supply chain interruptions, contract disputes and systems and logistics failures. In certain markets, distribution of the BAT Group's products is through third party monopoly channels, and is often licensed by governments. The BAT Group may be unable to renew these third party supplier and distribution agreements on satisfactory terms for numerous reasons, including government regulations. Loss of distribution may adversely affect the BAT Group's sales volume, market share and profits. Furthermore, for the RAI Group, revenues from two distributors, McLane Company, Inc. and Core-Mark International, Inc., constituted approximately 28% and 14%, respectively, of consolidated revenue for the year ended December 31, 2016. The loss of these customers, or a significant decline in their purchases, could have an adverse effect on the results of operations, cash flows and financial position of the BAT Group.

Additionally, there can be no assurance that any deterioration in labor or union relations, or any disputes or work stoppages or other labor related developments (including problems experienced during any consultation procedures or programs or the introduction of new labor regulations in countries where the BAT Group operates), will not increase the costs and upset the BAT Group's ability to supply products, which would adversely affect the BAT Group's business, financial condition and results of operations. This is particularly relevant in jurisdictions where the BAT Group's manufacturing facilities are more concentrated, such as in the United States upon the completion of the merger.

In addition, the BAT Group may not be able to establish or maintain relationships, on favorable commercial terms, with vendors willing to produce alternative products, or components or raw materials used in such products, resulting in additional expenditures for the BAT Group.

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

The BAT Group operates approximately 170 retirement benefit arrangements worldwide. These arrangements have been developed in accordance with local practices in the markets concerned. The majority of the BAT Group's scheme members belong to defined benefit schemes, most of which are funded externally, although the BAT Group operates an increasing number of defined contribution schemes. The contributions to the BAT Group's defined benefit schemes and their valuations are determined in accordance with the advice of independent, professionally qualified actuaries. The present total value of funded scheme liabilities as at December 31, 2016 was £7.2 billion (2015: £6.0 billion), while unfunded scheme liabilities amounted to £476 million (2015: £364 million). The schemes' assets increased from £6.1 billion in 2015 to £7.3 billion in 2016. After excluding unrecognized scheme surpluses of £18 million (2015: £11 million), the overall net liability for all pension and healthcare schemes in BAT Group subsidiaries amounted to £371 million at the end of 2016, compared to £245 million at the end of 2015.

In 2016, RAI contributed $335 million to its pension plans and $66 million to its postretirement plans. During 2017, RAI expects to contribute $111 million to its pension plans and $78 million to its postretirement plans. Unfunded liabilities totaled $1,026 million (2015: $1,387 million) for pension plans and $932 million (2015: $969 million) for postretirement plans.

Changes in asset returns, salary increases, inflation, long-term interest rates, life expectancies, population trends and other actuarial assumptions could have an adverse impact on the BAT Group's financial condition and

operations, hence adversely affect its credit rating and ability to raise funds. See "*Management's Discussion and Analysis of Financial Condition and Results of Operations of BAT — Critical Accounting Estimates*".

The BAT Group's business may be negatively affected by the economic conditions in the EU.

The BAT Group's businesses and performance are influenced by local and global economic conditions and perceptions of those conditions and future economic prospects. In recent years, the global markets and economic conditions have been negatively impacted by market perceptions regarding the ability of certain EU member states to service their sovereign debt obligations, together with the risk of contagion to other, more stable, countries. The large sovereign debts and/or fiscal deficits of a number of European countries have raised concerns regarding the financial condition of financial institutions, insurers and other corporations (1) located in these countries; (2) that have direct or indirect exposure to these countries; and/or (3) whose banks, counterparties, custodians, customers, service providers, sources of funding and/or suppliers have direct or indirect exposure to these countries.

The default, or a significant decline in the credit rating, of one or more sovereigns or financial institutions, as well as the breakup of or exit from the EU and/or eurozone by the United Kingdom or any other member state, could cause severe stress in the financial system generally and on the euro and other European currencies, could disrupt the banking system generally and adversely affect the markets in which the BAT Group operates and the businesses and economic condition and prospects of the BAT Group's counterparties, customers, suppliers or creditors, directly or indirectly, in ways which are difficult to predict. In addition, these risks, alone or in combination with regulatory changes, including devaluation of local currencies and increased inflation, or actions of market participants, may increase the BAT Group's exposure to foreign exchange rate risks and cause a loss of competitiveness from increased production cost and lower revenue, increased customer down-trading, significant write-downs of stock and a growth in illicit trade, which may adversely impact the BAT Group's business, results of operations and financial conditions.

Risk Factors Relating to BAT in connection with the Merger

The substantial additional indebtedness that BAT incurred in connection with the merger could adversely affect the BAT Group's financial position, including by decreasing the BAT Group's business flexibility and resulting in a further reduction of the BAT Group's credit rating.

Following completion of the merger, the BAT Group has substantially increased debt compared to the BAT Group's historical level of debt. As of June 30, 2017, BAT's consolidated net debt was £18.5 billion. BAT's pro forma net debt as of June 30, 2017, after giving effect to the merger, and excluding the offering of the Notes, as if it had been completed on June 30, 2017, would have been £47.1 billion, of which £26.8 billion, or 52%, of the estimated pro forma gross interest bearing debt of BAT following the merger would have been at variable rates of interest as of June 30, 2017. BAT incurred approximately $38 billion of additional debt in connection with the merger as a result of financing to complete the merger and debt assumed in the merger. These pro forma figures do not take into account the issuance of the Notes and the repayment of certain amounts outstanding under the acquisition facility with the proceeds therefrom. This increased level of debt could have the effect, among other things, of reducing the BAT Group's flexibility to respond to changing business and economic conditions and will have the effect of increasing the BAT Group's interest expense thereby tightening restrictive covenants under its revolving credit facility agreement. In addition, the amount of cash required to service the BAT Group's increased debt levels and increased aggregate dividends following completion of the merger and thus the demands on the BAT Group's cash resources will be greater than the amount of cash flows required to service the BAT Group's debt and pay dividends prior to the merger. The increased levels of debt and dividends following completion of the merger could also reduce funds available for the BAT Group's investments in research and development and capital expenditures, share repurchases and other activities and may create competitive disadvantages for the BAT Group relative to other companies with lower debt levels. See "*BAT Unaudited Pro Forma Condensed Combined Financial Information*" and note 20 to the BAT Group's consolidated financial statements included in this Offering Memorandum.

The BAT Group's credit rating impacts the cost and availability of future borrowings and, accordingly, BAT's cost of capital. The BAT Group's credit rating reflects each credit rating organization's opinion of the BAT Group's financial strength, operating performance and ability to meet debt obligations. Following announcement of the merger, Standard & Poor's Ratings Services downgraded the long-term rating of the BAT Group from A- to BBB+ and reaffirmed the A-2 short-term rating and Moody's Investors Service downgraded the long-term rating of the BAT Group from A3 to Baa2 and reaffirmed the P-2 short-term rating. The reduction in the BAT Group's credit rating by Standard & Poor's Ratings Services and Moody's Investors Service and any further reduction may limit BAT's ability to borrow at interest rates and terms consistent with the interest rates

and terms that have been available to BAT prior to the merger. If the BAT Group's credit rating is reduced further, BAT may not be able to sell additional debt securities or borrow money in the amounts, at the times or at interest rates or upon the more favorable terms and conditions that might be available if the BAT Group's current credit rating is maintained. Any impairment of BAT's ability to obtain future financing on favorable terms could have an adverse effect on BAT's ability to refinance existing debt.

In addition, future borrowings under circumstances in which the BAT Group's debt is rated below investment grade may contain further restrictions that impose significant restrictions on the way the BAT Group operates following the merger.

The Pro Forma Financial Information has been produced for informational purposes only and the actual results of operations, cash flows and financial position after the merger may differ materially.

The Pro Forma Financial Information is presented for informational purposes only and is not necessarily indicative of the combined financial position or results of operations that would have been realized had the merger occurred as of the dates indicated, nor is it meant to be indicative of any anticipated combined financial position or future results of operations that the BAT Group will experience after the completion of the merger. The unaudited pro forma adjustments are based upon the best available information and certain assumptions that BAT believes to be reasonable. For example, the estimated purchase price allocation included in the Pro Forma Financial Information is preliminary and based on information currently available. The actual fair values used in the purchase price allocation will be determined upon the completion of the merger and may vary materially from these preliminary estimates. In addition, the LIBOR interest rate and the BAT Group's credit rating (each of which impacts BAT's cost of financing), BAT's share price and exchange rates at the time of the closing of the merger would all have a material impact on the total acquisition price, related financing costs and the accuracy of the Pro Forma Financial Information. The Pro Forma Financial Information does not reflect any adjustment for liabilities or related costs of any integration and similar activities, or benefits, including potential synergies that may be derived in future periods, from the merger. The Pro Forma Financial Information has been prepared in accordance with Annex II of the Prospectus Directive Regulation and not in accordance with the requirements of Regulation S-X under the Securities Act. See "*BAT Unaudited Pro Forma Condensed Combined Financial Information*".

BAT may fail to successfully integrate RAI into its business, and the BAT Group may fail to realize the expected synergies and other benefits of the merger and the combined businesses may not perform as expected.

BAT and RAI and their respective subsidiaries and affiliates have operated independently until the completion of the merger, and there can be no assurances that their businesses can be integrated successfully. The success of the merger will depend, in part, on BAT's ability to successfully integrate RAI into its business and the ability of the BAT Group to realize the expected synergies and other benefits from combining the businesses of the historical BAT Group and the RAI Group. There is also no assurance that the costs to integrate and achieve the synergies will not be higher than anticipated. The BAT Group's ability to successfully combine and integrate the businesses of the historical BAT Group and the RAI Group and the BAT Group's ability to realize these anticipated benefits and cost savings is subject to certain risks, including the following:

- changes or conflicts in corporate culture, controls, procedures and systems;
- retaining existing employees and attracting new employees;
- maintaining relationships with customers, suppliers and other constituencies; and
- inefficiencies associated with the integration and management of the operations of the BAT Group.

In addition, the BAT Group will be required to devote significant management attention and resources to integrating the business practices and operations of the historical BAT Group and the RAI Group, which may result in diversion of the attention of each group's management and employees from ongoing operations, the lack of personnel or other resources to pursue other potential business opportunities and the disruption of, or the loss of momentum in, each group's ongoing businesses.

If the BAT Group is not able to successfully combine the businesses of the historical BAT Group and the RAI Group within the anticipated timeframe, or at all, the expected synergies and other benefits of the merger may not be realized fully or at all or may take longer to realize than expected and the combined businesses may not perform as expected. Accordingly, the contemplated benefits of the merger may not be realized fully, or at all, or may take longer to realize than expected.

The BAT Group has incurred and will continue to incur significant transaction-related costs in connection with the merger.

The BAT Group has incurred and will continue to incur significant costs associated with the merger and combining the operations of the historical BAT Group and the RAI Group. The significant costs associated with the merger include, among others, fees and expenses of financial advisors and other advisors and representatives, certain employment-related costs relating to employees of RAI, fees and expenses related to the acquisition facility and the refinancing of the acquisition facility, costs of defending any potential shareholder litigation related to the merger, costs of public relations firms engaged in connection with the merger, filing fees due in connection with filings required under the HSR Act and filing fees and printing and mailing costs for the proxy statement/prospectus related to the merger and filed with the SEC in the United States and filings related to the merger in the UK. Some of these costs have already been incurred. The BAT Group also has and will continue to incur fees and costs related to formulating and implementing integration plans with respect to the two companies, including systems integration costs. BAT continues to assess the magnitude of these costs, and additional unanticipated costs may be incurred in the merger and the integration of the two companies' businesses. The expected net benefits associated with these costs may not be achieved in the near term, or at all.

The BAT Group may have to make additional contributions to fund RAI's pension and other post-retirement benefit plans in addition to BAT's own plans.

The BAT Group currently maintains and contributes to defined benefit pension plans and other post-retirement benefit plans that cover various categories of employees and retirees. The obligation to make contributions to fund benefit obligations under these pension and other post-retirement benefit plans is based on actuarial valuations, which are based on certain assumptions, including the long-term return on plan assets and discount rate. The BAT Group may have to make additional contributions following the completion of the merger to fund RAI's pension and other post-retirement benefit plans in addition to the historical BAT plans. In addition, changes to pension legislation or changes in pension accounting may adversely affect pension and post-retirement expense. Additional contributions could have an adverse effect on the cash flows of the BAT Group.

As a result of the merger, BAT's exposure to risks related to the U.S. cigarette market has increased, which could have an adverse effect on the results of operations, cash flows and financial position of BAT following completion of the merger.

BAT's subsidiaries' exposure, following the merger, to the U.S. cigarette market, and the commercial risks related thereto, increased (by virtue of BAT's ownership of 100% of RAI's equity). The RAI Group is dependent on the U.S. cigarette market, which is expected to continue to decline. After completion of the merger, BAT's subsidiaries' U.S. combustible cigarette brands include, among others, Newport, Camel, Pall Mall and Natural American Spirit. For the year ended December 31, 2016, the RAI Group's sales in the United States attributable to combustible cigarettes represented approximately 89% of its 2016 consolidated net sales. The BAT Group's sales in the United States attributable to combustible cigarettes would have represented approximately 34% of the BAT Group's pro forma 2016 net sales, assuming the merger had occurred on January 1, 2016.

The BAT Group's exposure to the decline of U.S. cigarette consumption has increased by virtue of the merger. Such consumption has declined for a variety of factors, including, for example, price increases, restrictions on advertising and promotions, smoking prevention campaigns, increases in regulation and excise taxes, health concerns, a decline in the social acceptability of smoking, increased pressure from anti-tobacco groups, and migration to smokeless products. MSAi reported that, on a year-over-year basis, U.S. cigarette shipments declined 2.4% in 2016, 0.1% in 2015 and 3.2% in 2014. U.S. cigarette consumption is expected to continue to decline and any such decline or the transition of adult tobacco consumers away from premium cigarette brands in the U.S. could have an adverse effect on the results of operations, cash flows and financial position of the BAT Group.

In addition, the RAI Group is dependent on premium cigarette brands, such as Newport, with premium brands accounting for approximately 73% of the cigarette volume of subsidiaries of the RAI Group in 2016. As a result, the BAT Group is susceptible to consumer price sensitivities and adverse financial or economic conditions that could increase the number of consumers switching to a lower-priced brand.

As a result of increased exposure to the U.S. cigarette market, the BAT Group's exposure to risks such as the inability to keep up with competitor actions, and the inability to raise prices to compensate for declines in sales volumes and increases in excise taxes will also increase. For more information on risks related to BAT's increased exposure to the U.S. cigarette market following completion of the merger, see, *"Completion of the merger resulted in BAT becoming subject to U.S. regulations which are different from the regulations to which BAT is currently subject. Current and future U.S. regulations could have an adverse effect on the results of operations, cash flows and financial position of the BAT Group."*

BAT, through its subsidiaries, has acquired RJR Tobacco Company's Newport brand, the leading U.S. menthol cigarette brand, and any action by the FDA or any other governmental authority that could have the effect of banning or materially restricting the use of menthol in tobacco products could have a material adverse effect on sales of the Newport brand and the menthol styles of other brands of RAI's operating subsidiaries, which could have an adverse effect on the results of operations, cash flows and financial position of the BAT Group.

As a result of the merger, BAT, through its subsidiaries, acquired RJR Tobacco Company's Newport brand, the leading U.S. menthol cigarette brand, the sales of which, together with the other menthol brands of RAI's operating subsidiaries, represent a substantial portion of RAI's total net sales. RAI estimates that approximately 50% of its total consolidated net sales were attributable to menthol cigarettes for the year ended December 31, 2016. In 2013, the FDA issued its preliminary scientific evaluation regarding menthol cigarettes, concluding that menthol cigarettes adversely affect initiation, addiction and cessation compared to non-menthol cigarettes. In 2013, the FDA also issued an ANPRM, seeking comments on various issues relating to the potential regulation of menthol cigarettes. More recently, on July 28, 2017, the FDA confirmed that it would issue an ANPRM to seek public comment on the role that flavors (including menthol) in tobacco products play in attracting youth and may play in helping some smokers switch to potentially less harmful forms of nicotine delivery.

Although it is not possible to predict whether or when the FDA will take actions, if the FDA or any other governmental authority were to adopt regulations banning or severely restricting the use of menthol in tobacco products or the sale of menthol cigarettes, those regulations could have a material adverse effect on sales of the Newport brand and the menthol styles of other brands of RAI's operating subsidiaries, which could have an adverse effect on the results of operations, cash flows and financial position of the BAT Group.

Risk Factors Relating to the Issuer, the Guarantors and the Notes

Active trading markets for the Notes may not develop, and the transfer of the Notes will be subject to restrictions.

The Notes are a class of securities that have never been traded. We have applied for the admission of the Notes to listing on the Official List of the UK Listing Authority and to trading on the PSM. However, we cannot assure you that the Notes will be listed on any exchange at the time the Notes are delivered to the Initial Purchasers or at any other time. The Initial Purchasers have informed us that they intend to make a market in each series of the Notes. However, they are not obliged to do so, and may discontinue such market-making at any time without notice.

There can be no assurance that active trading markets for the Notes will develop, or, if they do develop, that they will be sustained or remain liquid. If active trading markets do not develop or are not maintained, the market or trading price and liquidity of the Notes may be adversely affected. Therefore, investors may not be able to sell their Notes easily or at prices that will provide them with a yield comparable to similar investments that have developed a secondary market. This is particularly the case for Notes that are especially sensitive to interest rates, currency or market risks, are designed for specific investment objectives or strategies, or have been structured to meet the investment requirements of limited categories of investors. Those types of Notes generally would have a more limited secondary markets and more price volatility than conventional debt securities. Illiquidity may have a severely adverse effect on the market value of the Notes.

The Notes and the Guarantees have not been registered under the Securities Act or any U.S. state securities laws. Accordingly, the Notes and related Guarantees can only be offered or sold pursuant to an exemption from, or in a transaction not subject to, the registration requirements of the Securities Act and applicable U.S. state securities laws. Therefore, a Noteholder may be required to bear the risk of its investment for an indefinite period. It is your obligation to ensure that your offers and sales of the Notes within the United States and other markets comply with applicable securities laws. See "*Notice to Investors*".

Under the Registration Rights Agreement, we have agreed to use commercial reasonable efforts to (i) file a registration statement with the SEC with respect to a registered offer to exchange the Notes of each series offered hereby for new Notes of the same series having terms substantially identical to the Notes offered hereby (except that such new Notes will not contain terms with respect to transfer restrictions or the payment of additional interest) and (ii) in certain circumstances, file a shelf registration statement with respect to resales of the Notes of each series. The SEC, however, has broad discretion as to whether to declare any registration statement effective and may delay, defer or suspend the effectiveness of any registration statement for a variety of reasons. Any delay in, or denial of, the effectiveness of a registration statement, could adversely affect the liquidity and price of the Notes. Further, if a registration statement is not declared effective, ceases to be effective or you do not exchange your Notes, your ability to transfer the Notes will be restricted.

BAT, RAI and BATHTN are holding companies, and the Issuer, BATIF and BATNF are financing companies with no revenue-generating operations.

BAT, RAI and BATHTN are holding companies and the Issuer, BATIF and BATNF are financing companies with no revenue-generating operations of their own. The business of BAT is carried out through a number of operating subsidiaries and associated companies. Consequently, BAT, RAI, BATHTN, the Issuer, BATIF and BATNF will depend upon dividend and other payments from operating subsidiaries to provide the funds necessary to pay the principal of, and the interest on, the Notes or make payments under the Guarantees, as the case may be. These operating subsidiaries and associated companies have not guaranteed the Notes, and have no obligation, contingent or otherwise, to pay amounts due under the Notes or the Guarantees or to make funds available for these payments, whether in the form of loans, dividends or otherwise. The ability of the operating subsidiaries to make dividend or other payments to BAT, RAI, BATHTN, the Issuer, BATIF or BATNF will depend on their cash flows and earnings which, in turn, will be affected by all of the factors discussed herein. In addition, under the corporate laws of many jurisdictions, including the United Kingdom, the ability of some subsidiaries and associates to pay dividends is limited to the amount of distributable reserves of such companies.

Noteholders will have a direct claim based on the Notes against the Issuer and based on the Guarantees against the Guarantors, but will not have a direct claim based on the Notes or the Guarantees against any operating subsidiaries. The right of the Noteholders to receive payments under the Notes and the Guarantees will be structurally subordinated to all liabilities of the operating subsidiaries and associated companies. These liabilities include debt that some of our subsidiaries have incurred under bank facilities or debt securities. In the event of a bankruptcy, liquidation, reorganization or similar proceeding relating to a subsidiary, the right of Noteholders to participate in a distribution of the assets of such subsidiary will rank behind such subsidiary's and associated companies creditors (including trade creditors) and preferred stockholders (if any), except to the extent that BAT, RAI, BATHTN, the Issuer, BATIF or BATNF have direct claims against such subsidiary.

Any Guarantees provided by certain Subsidiary Guarantors will be automatically released in certain circumstances.

The Indenture will provide that a Guarantee provided by a Subsidiary Guarantor (including RAI) other than BATIF, and the Dutch Guarantors will automatically be released under certain circumstances without consent of the holders of the Notes or the Trustee. The Guarantee of such Subsidiary Guarantor will be terminated and be of no further force or effect in the event that (1) its guarantee of all then outstanding notes issued under the EMTN Programme (as defined in the "*Description of the Notes and the Guarantees*") is released or (2) at substantially the same time its Guarantee of the Notes is terminated, the Subsidiary Guarantor is released from all obligations in respect of indebtedness for borrowed money for which such Subsidiary Guarantor is an obligor (as a guarantor or borrower). For purposes of this paragraph, the amount of a Subsidiary Guarantor's indebtedness for borrowed money shall not include (A) the Notes issued pursuant to the Indenture, (B) any other debt the terms of which permit the termination of such Subsidiary Guarantor's guarantee of such debt under similar circumstances, as long as such Subsidiary Guarantor's obligations in respect of such other debt are terminated at substantially the same time as its guarantee of the Notes, (C) any debt that is being refinanced at substantially the same time that the guarantee of the Notes is being released, provided that any obligations of the relevant Subsidiary Guarantor in respect of the debt that is incurred in the refinancing shall be included in the calculation of the relevant Subsidiary Guarantor's indebtedness for borrowed money and (D) for the avoidance of doubt, any debt in respect of which such Subsidiary Guarantor is an obligor (as a guarantor or borrower) (i) between or among the Parent Guarantor and any subsidiary or subsidiaries thereof or (ii) between or among any subsidiaries of the Parent Guarantor. See "*Description of the Notes and Guarantees — Status of the Notes and Guarantees — Release*".

If the Guarantee by a Subsidiary Guarantor is released, the Issuer and the Parent Guarantor are not required to replace such Guarantee, and the Notes will have the benefit of fewer subsidiary guarantees for the remaining maturity of the Notes.

RAI is the only Subsidiary Guarantor as of the date hereof whose Guarantee may be released by this provision. The guarantee release provisions described here will apply to future Subsidiary Guarantors.

The Notes will initially be held in book-entry form and therefore you must rely on the procedures of relevant clearing systems to exercise any rights and remedies.

Unless and until Notes in definitive registered form, or definitive registered Notes, are issued in exchange for book-entry interests, owners of book-entry interests will not be considered owners or holders of notes. DTC, or its nominee, will be the registered holder of the Rule 144A and Regulation S Global Notes for the benefit of its participants including Euroclear and Clearstream, Luxembourg. After payment to the registered holder, we will

have no responsibility or liability for the payment of interest, principal or other amounts to the owners of book-entry interests. Accordingly, if you own a book-entry interest, you must rely on the procedures of DTC, Euroclear and/or Clearstream, Luxembourg, and if you are not a participant in DTC, Euroclear and/or Clearstream, Luxembourg, on the procedures of the participants through which you own your interest, to exercise any rights and obligations of a holder under the Indenture. See "*Book Entry, Delivery and Form*".

Unlike the holders of Notes themselves, owners of book-entry interests will not have any direct rights to act upon our solicitations for consents, requests for waivers or other actions from holders of the Notes. Instead, if you own a book-entry interest, you will be permitted to act only to the extent you have received appropriate proxies to do so from DTC, Euroclear and/or Clearstream, Luxembourg or, if applicable, from a participant. There can be no assurance that procedures implemented for the granting of such proxies will be sufficient to enable you to vote on any matters on a timely basis.

Similarly, upon the occurrence of an event of default under either Indenture, unless and until definitive registered notes are issued in respect of all book-entry interests, if you own a book-entry interest, you will be restricted to acting through DTC, Euroclear and/or Clearstream, Luxembourg. The procedures to be implemented through DTC, Euroclear and/or Clearstream, Luxembourg may not be adequate to ensure the timely exercise of rights under the Notes. See "*Book Entry, Delivery and Form*".

Investors in the Notes may have limited recourse against the independent auditors.

In accordance with guidance issued by The Institute of Chartered Accountants in England and Wales, the independent auditors' reports with respect to the BAT financial statements state that: they were made solely to BAT's members (as applicable), as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006; the independent auditors' work was undertaken so that the independent auditors might state to the relevant members those matters that were required to state to them in an auditors' report and for no other purpose; and, to the fullest extent permitted by law, the independent auditors do not accept or assume responsibility to anyone other than BAT's members as a body (as applicable), for their audit work or the opinions they have formed. The independent auditors' reports in respect of BAT are included in this Offering Memorandum. The SEC would not permit such limiting language to be included in a registration statement or a prospectus used in connection with an offering of securities registered under the Securities Act or in a report filed under the Exchange Act. If a U.S. court (or any other court) were to give effect to such limiting language, the recourse that investors in the Notes may have against the independent auditors based on their report or the consolidated financial information to which it relates could be limited. See "*Independent Auditors*".

A holder's actual yield on the Notes may be reduced from the stated yield by transaction costs.

When Notes are purchased or sold, several types of incidental costs (including transaction fees and commissions) are incurred in addition to the current prices of the security. These incidental costs may significantly reduce or even exclude the profit potential of the Notes. For instance, credit institutions as a rule charge their clients for their own commissions which are either fixed minimum commissions or pro-rata commissions depending on the order value. To the extent that additional domestic or foreign parties are involved in the execution of an order, including but not limited to domestic dealers or brokers in foreign markets, holders must take into account that they may also be charged for the brokerage fees, commissions and other fees and expenses of such parties.

A holder's effective yield on the Notes may be diminished by the tax impact on that holder of its investment in the Notes.

Payments of interest on the Notes, or profits realized by the holder upon the sale or repayment of the Notes, may be subject to taxation in its home jurisdiction or in other jurisdictions in which it is required to pay taxes. However, the tax impact on an individual holder may differ from the situation described for holders generally. See "*Certain Taxation Considerations*".

Floating Rate Notes can be a volatile investment and the potential phasing out of LIBOR after 2021 may adversely affect the value of the Floating Rate Notes.

The interest of the Noteholders of each series of Notes may not be consistent with those of the Noteholders of the other series. For example, the Floating Rate Notes will bear interest at a floating rate and will have other features that will differ from the other series of Notes offered hereby. As a result of these differences, the interests of Noteholders of the Floating Rate Notes and the interests of the other Noteholders could conflict. A holder of a Floating Rate Note carries the risk of fluctuating interest rate levels and uncertain interest earnings. Interest rate fluctuations make it impossible to determine the yield of Floating Rate Notes in advance. Investors in Floating Rate Notes should bear in mind that neither the current nor the historical level of the relevant floating interest rate is an indication of the future development of such floating interest rate during the term of any Floating Rate Note.

On July 27, 2017, the UK Financial Conduct Authority ("FCA") announced that it will no longer persuade or compel banks to submit rates for the calculation of the LIBOR rates after 2021 (the "FCA Announcement"). It is not possible to predict the effect of the FCA Announcement, any changes in the methods pursuant to which the LIBOR rates are determined and any other reforms to LIBOR, including to the rules promulgated by the FCA in relation thereto, that will be enacted in the UK and elsewhere, which may adversely affect the trading market for LIBOR based securities, including the Floating Rate Notes, or result in the phasing out of LIBOR as a reference rate for securities. In addition, any changes announced by the FCA (including the FCA Announcement), ICE Benchmark Administration Limited as independent administrator of LIBOR or any other successor governance or oversight body, or future changes adopted by such body, in the method pursuant to which the LIBOR rates are determined may result in a sudden or prolonged increase or decrease in the reported LIBOR rates. If that were to occur, the level of interest payments and the value of the Floating Rate Notes may be affected. Further, uncertainty as to the extent and manner in which the UK government's recommendations following its review of LIBOR in September 2012 will continue to be adopted and the timing of such changes may adversely affect the current trading market for LIBOR based securities and the value of the Floating Rate Notes.

The Notes and Guarantees are unsecured obligations of the Issuer and the Guarantors, respectively, and are subordinated to secured obligations on insolvency.

Holders of secured obligations of the Issuer will have claims that are prior to the claims of holders of the Notes to the extent of the value of the assets securing those other obligations. The Notes and the Guarantees are effectively subordinated to secured indebtedness to the extent of the value of the assets securing those other obligations. In the event of any distribution of assets or payment in any foreclosure, dissolution, winding-up, liquidation, reorganization, or other bankruptcy proceeding, the assets securing the claims of secured creditors will be available to satisfy the claims of those creditors, if any, before they are available to unsecured creditors, including the holders of the Notes. In any of the foregoing events, there is no assurance to holders of the Notes that there will be sufficient assets to pay amounts due on the Notes. As a result, holders of the Notes may receive less, ratably, than holders of secured obligations.

The trading market for debt securities may be volatile and may be adversely impacted by many events.

The market for debt securities is influenced by economic and market conditions, interest rates, currency exchange rates, and inflation rates in the European Union and other industrialized countries and areas. There can be no assurance that events in the eurozone or elsewhere will not cause market volatility, or that such volatility will not adversely affect the price of the Notes or that economic and market conditions will not have any other adverse effect.

Exchange rate risks and exchange controls may adversely impact currency conversions of principal and interest paid on the Notes.

The Issuer will pay principal and interest on the Notes in U.S. dollars (the "Specified Currency"). This presents certain risks relating to currency conversions if an investor's financial activities are denominated principally in a currency or currency unit (the "Investor's Currency") other than the Specified Currency. These include the risk that exchange rates may significantly change (including changes due to devaluation of the Specified Currency or revaluation of the Investor's Currency) and the risk that authorities with jurisdiction over the Investor's Currency may impose or modify exchange controls. An appreciation in the value of the Investor's Currency relative to the Specified Currency would decrease the Investor's Currency equivalent yield on the Notes, the Investor's Currency equivalent value of the principal payable on the Notes and the Investor's Currency equivalent market value of the Notes.

Credit ratings may not reflect all risks, are not recommendations to buy or hold securities and may be subject to revision, suspension or withdrawal at any time.

One or more independent credit rating agencies may assign credit ratings to the Notes. The ratings may not reflect the potential impact of all risks related to structure, market, additional factors discussed above and other factors that may affect the value of the Notes. A credit rating is not a recommendation to buy, sell or hold securities and may be revised or withdrawn by the rating agency at any time.

We may be able to incur substantially more debt in the future.

We may be able to incur substantial additional indebtedness in the future, including in connection with future acquisitions, some of which may be secured by some or all of our assets. The terms of the Notes will not limit the amount of indebtedness we may incur. Any such incurrence of additional indebtedness could exacerbate the related risks that we now face.

USE OF PROCEEDS

The proceeds to the Issuer from the offering are estimated to be approximately $17,176,750,000, after deducting commissions. The net proceeds from the offering of the Notes will be used to repay a portion of the amounts outstanding under the acquisition facility, pay merger related fees and expenses, and for general corporate purposes, which may include the repayment of certain outstanding debt.

The Issuer and BATIF borrowed $25.0 billion pursuant to the acquisition facility in order to finance the cash portion of the merger consideration, which was paid on July 25, 2017, and to pay related taxes, fees, costs and expenses. The borrowings are under four credit facilities and mature as follows: Facility A (bridge facility) - $15.0 billion - July 17, 2018 (subject to two six-month extension options exercisable at BAT's option); Facility B (bridge facility) - $5 billion - July 17, 2019 (subject to two six-month extension options exercisable at BAT's option); Facility C (term loan) - $2.5 billion - July 17, 2020, and Facility D (term loan) - $2.5 billion – January 16, 2022. The acquisition facility bears interest at a rate per annum equal to LIBOR (or in the case of euro- denominated borrowings, EURIBOR) plus the applicable margin, which, based on BAT's current ratings as assessed by Standard & Poor's Ratings Services and Moody's Investors Service, are as follows: (1) Facility A: between 0.5125% and 1.5625% per annum based on the applicable borrowing period; (2) Facility B: between 0.5625% and 2.2125% per annum based on the applicable borrowing period; (3) Facility C: 0.70% per annum; and (4) Facility D: 0.80% per annum. These rates are subject to adjustments in accordance with the terms of the acquisition facility based on the applicable credit rating assigned to the BAT Group. If the LIBOR or EURIBOR rate is below zero, such rate shall be deemed to be zero.

See *"Management's Discussion and Analysis of Financial Condition and Results of Operations of BAT — Liquidity and Capital Resources"*.

Affiliates of certain of the Initial Purchasers are lenders under the acquisition facility and, accordingly, they will receive a portion of the net proceeds from the offering of the Notes through the repayment of borrowings under the acquisition facility. See "*Plan of Distribution*".

CAPITALIZATION AND INDEBTEDNESS

The following table sets forth our consolidated cash and cash equivalents, capitalization and indebtedness as of June 30, 2017, on an actual basis and on a pro forma basis, reflecting the effects of the merger and borrowing under the acquisition facility.

You should read this table in conjunction with "*Management's Discussion and Analysis of Financial Condition and Results of Operations of BAT*", "*BAT Unaudited Pro Forma Condensed Combined Financial Information*" and our audited consolidated financial information, the related notes and the other financial information included in this Offering Memorandum.

The information in this table is extracted directly and/or derived from the "*BAT Unaudited Pro Forma Condensed Combined Financial Information*" section and does not represent new pro forma information. This table does not give effect to the offering of the Notes and the use of proceeds therefrom. See "*Use of Proceeds*".

	Actual as of June 30, 2017	**Pro Forma as of June 30, 2017(1)**
	(£ millions)	
Total cash and cash equivalents(2)	2,019	3,735
Current borrowings(3)	5,822	7,165
Non-current borrowings(4)	15,085	24,991
Borrowings under acquisition facility(5)	—	19,075
Total borrowings(6)	20,907	51,231
Share capital(7)	507	615
Share premium, capital redemption and merger reserves(8)	3,933	26,963
Other reserves(9)	(111)	(111)
Retained earnings(10)	3,388	25,943
Total equity attributable to owners of parent(11)	7,717	53,410
Total capitalization and indebtedness(12)	28,624	104,641

Notes:

(1) The amounts shown are the pro forma capitalization as of June 30, 2017 for the BAT Group extracted directly and/or derived from the "*Unaudited Pro Forma Condensed Combined Financial Information*" section.

(2) Pro forma cash and cash equivalents comprise the BAT Group's cash and cash equivalents at June 30, 2017 of £2,019 million, RAI's cash and cash equivalents at June 30, 2017 of £1,345 million ($1,758 million) and pro forma financing and merger related adjustments to cash and cash equivalents of £371 million.

(3) Current borrowings include the portion of bonds and notes, commercial paper, other loans, bank loans, bank overdrafts and finance leases due within one year. Pro forma current borrowings comprise the BAT Group's current borrowings at June 30, 2017 of £5,822 million, RAI's current borrowings at June 30, 2017 of £1,338 million ($1,748 million) and pro forma financing and merger related adjustments to current borrowings of £11,453 million. Pro forma current borrowings do not include the current portion of the borrowings under the acquisition facility (see (5) below).

(4) Non-current borrowings include the portion of bonds and notes, commercial paper, other loans, bank loans, bank overdrafts and finance leases due after one year. Pro forma non-current borrowings comprise the BAT Group's non-current borrowings at June 30, 2017 of £15,085 million, RAI's non-current borrowings at June 30, 2017 of £8,715 million ($11,390 million) and pro forma financing and merger related adjustments to non-current borrowings of £8,818 million. Pro forma non-current borrowings do not include the non-current portion of the borrowings under the acquisition facility (see (5) below).

(5) Pro forma borrowings under the acquisition facility include a non-current portion of £7,627 million and a current portion of £11,448 million.

(6) Pro forma total borrowings comprise pro forma current borrowings, pro forma non-current borrowings and pro forma borrowings under the acquisition facility.

(7) Pro forma share capital is impacted by the issuance of BAT common shares in the form of ADSs to RAI shareholders, other than the BAT Group, in connection with the merger.

(8) Pro forma share premium, capital redemption and merger reserves comprise the BAT Group's share premium, capital redemption and merger reserves at June 30, 2017 of £3,933 million, RAI's share premium, capital redemption and merger reserves at June 30, 2017 of £13,924 million ($18,197 million) and pro forma financing and merger related adjustments to share premium, capital redemption and merger reserves of £9,106 million.

(9) Pro forma other reserves comprise the BAT Group's other reserves at June 30, 2017.

(10) Pro forma retained earnings comprise the BAT Group's retained earnings at June 30, 2017 of £3,388 million, RAI's retained earnings at June 30, 2017 of £3,058 million ($3,966 million) and pro forma financing and merger related adjustments to retained earnings of £19,497 million.

(11) Pro forma total equity attributable to owners of the parent includes pro forma share capital, pro forma share premium, capital redemption and merger reserves, pro forma other reserves and pro forma retained earnings.

(12) Pro forma total capitalization and indebtedness includes total borrowings and total equity attributable to owners of the parent.

SELECTED HISTORICAL CONSOLIDATED FINANCIAL DATA OF BAT

The following table presents selected historical consolidated financial data of BAT prepared in accordance with IFRS. The selected historical consolidated financial data as of December 31, 2016, 2015 and 2014 and for each of the years in the three-year period ended December 31, 2016, are derived from the BAT Group's consolidated financial statements and accompanying notes, which are included in this Offering Memorandum.

The unaudited selected historical consolidated financial data as of June 30, 2017 and 2016 and for the six months ended June 30, 2017 and 2016 are derived from the BAT Group's unaudited condensed consolidated financial statements and accompanying notes, which are included in this Offering Memorandum. The unaudited selected historical consolidated financial data presented have been prepared on a basis consistent with BAT's consolidated financial statements. In the opinion of BAT management, such unaudited financial data reflect all adjustments, consisting only of normal and recurring adjustments, necessary for a fair presentation of the results for those periods. The results of operations for the interim periods are not necessarily indicative of the results to be expected for the full year or any future period.

The information set forth below is only a summary and is not necessarily indicative of the results of BAT or the BAT Group following completion of the merger, and you should read the following information together with the BAT Group's consolidated financial statements, the BAT Group's unaudited condensed consolidated financial statements and the sections entitled "*Management's Discussion and Analysis of Financial Condition and Results of Operations of BAT*".

	As of and for the Six Months Ended June 30,[1]		**As of and for the Year Ended December 31,**[1]		
	2017	**2016**	**2016**	**2015**	**2014**
			(£ millions)		
Income statement data:					
Revenue[2]	7,717	6,669	14,751	13,104	13,971
Raw materials and consumables used	(1,881)	(1,630)	(3,777)	(3,217)	(3,088)
Changes in inventories of finished goods and work in progress	(59)	8	44	184	58
Employee benefit costs	(1,144)	(1,034)	(2,274)	(2,039)	(2,194)
Depreciation, amortization and impairment costs	(346)	(253)	(607)	(428)	(523)
Other operating income	55	49	176	225	178
Other operating expenses	(1,768)	(1,596)	(3,658)	(3,272)	(3,856)
Profit from operations	2,574	2,213	4,655	4,557	4,546
Net finance (costs)/income	(325)	(233)	(637)	62	(417)
Share of post-tax results of associates and joint ventures	778	1,446	2,227	1,236	719
Profit before taxation	3,027	3,426	6,245	5,855	4,848
Taxation on ordinary activities	(680)	(685)	(1,406)	(1,333)	(1,455)
Profit for the year	2,347	2,741	4,839	4,522	3,393
Balance sheet data:					
Assets:					
Non-current assets	27,712	25,550	27,414	21,701	17,035
Current assets	11,474	10,689	12,359	9,814	9,132
Total assets	39,186	36,239	39,773	31,515	26,167
Liabilities:					
Non-current liabilities	18,081	18,200	19,511	17,477	11,584
Current liabilities	13,196	11,787	11,856	9,006	8,769
Total borrowings	20,907	20,231	19,495	17,001	12,258
Equity:					
Share capital	507	507	507	507	507
Total equity	7,909	6,252	8,406	5,032	5,814
Cash flow data:					
Net cash generated from operating activities	1,706	1,054	4,610	4,720	3,716
Net cash used in investing activities	(297)	(220)	(640)	(3,991)	(470)
Net cash used in financing activities	(1,511)	(1,051)	(4,229)	(219)	(3,467)

(1) All of the information above is in respect of continuing operations. The historical financial data for the six months ended June 30, 2017 and 2016 is unaudited.

(2) Revenue is net of duty, excise and other taxes of £32,136 million, £27,896 million, and £28,535 million for the years ended December 31, 2016, 2015, and 2014, respectively, and £17,377 million and £14,364 million for the six months ended June 30, 2017 and 2016, respectively.

SELECTED HISTORICAL CONSOLIDATED FINANCIAL DATA OF RAI

The following table presents selected historical consolidated financial data of RAI prepared in accordance with U.S. GAAP. The selected historical consolidated financial data as of December 31, 2016, 2015, and 2014 and for each of the years in the three-year period ended December 31, 2016, are derived from the RAI Group's consolidated financial statements and accompanying notes, which are included in this Offering Memorandum.

The unaudited selected historical consolidated financial data of RAI as of June 30, 2017 and for the six months ended June 30, 2017 and 2016, are derived from the RAI Group's unaudited condensed consolidated financial statements and accompanying notes, which are included in this Offering Memorandum. The unaudited selected historical consolidated financial data presented have been prepared on a basis consistent with RAI's consolidated financial statements. In the opinion of BAT Group management, such unaudited financial data reflect all adjustments, consisting only of normal and recurring adjustments, necessary for a fair presentation of the results for those periods. The results of operations for the interim periods are not necessarily indicative of the results to be expected for the full year or any future period.

The selected historical consolidated financial data below includes the results of Lorillard from its acquisition date of June 12, 2015 onwards. In light of the Lorillard merger and the Lorillard Divestiture of certain assets in relation thereto, RAI's results of operations for the six months ended June 30, 2017 and 2016 and the years ended December 31, 2016 and 2015, and financial positions as at June 30, 2017 and December 31, 2016 and 2015 are not directly comparable to prior reporting periods. The information set forth below is only a summary and is not necessarily indicative of the results of RAI or the BAT Group following completion of the merger, and you should read the following information together with the RAI Group's consolidated financial statements, the RAI Group's unaudited condensed consolidated financial statements and the sections entitled "*Management's Discussion and Analysis of Financial Condition and Results of Operations of RAI*".

	As of and for the Six Months Ended June 30, (Unaudited)		As of and for the Years Ended December 31,		
	2017	**2016[1]**	**2016[1]**	**2015[2]**	**2014**
	(dollars in millions)				
Results of Operations:					
Net sales[3]	$ 6,201	$ 6,003	$12,277	$10,416	$ 8,160
Net sales, related party[4]	66	109	226	259	311
Net sales[3]	6,267	6,112	12,503	10,675	8,471
Costs and expenses					
Cost of products sold[3]	2,477	2,440	4,841	4,688	4,058
Selling, general and administrative expenses	896	964	1,931	2,098	1,871
Gain on divestiture	—	(4,861)	(4,861)	(3,181)	—
Amortization expense	12	12	23	18	11
Asset impairment and exit charges	—	—	—	99	—
Operating income	2,882	7,557	10,569	6,953	2,531
Interest and debt expense	299	326	626	570	286
Interest income	(5)	(5)	(8)	(6)	(3)
Other (income) expense, net	15	251	260	5	(14)
Income from continuing operations before income taxes	2,573	6,985	9,691	6,384	2,262
Provision for income taxes	874	2,624	3,618	3,131	817
Income from continuing operations[5]	1,699	4,361	6,073	3,253	1,445
Income from discontinued operations, net of tax	—	—	—	—	25
Net income	$ 1,699	$ 4,361	$ 6,073	$ 3,253	$ 1,470
Balance Sheet Data (at end of periods):					
Current assets[6]	$ 3,636		$ 4,238	$ 5,155	$ 2,619
Total assets[7]	50,463		51,095	52,100	14,781
Current liabilities	5,542		4,985	5,291	3,544
Long-term debt (less current maturities)[8]	11,390		12,664	16,849	4,602
Total liabilities[7]	28,577		29,384	33,848	10,259
Shareholders' equity	21,886		21,711	18,252	4,522

	As of and for the Six Months Ended June 30, (Unaudited)		As of and for the Years Ended December 31,		
	2017	2016[1]	2016[1]	2015[2]	2014
	(dollars in millions)				
Cash Flow Data:					
Net cash from (used in) operating activities	$ 1,277	$ (725)	$ 1,280	$ 196	$ 1,623
Net cash from (used in) investing activities	(65)	5,103	5,078	(10,005)	(205)
Net cash from (used in) financing activities	(1,523)	(5,034)	(6,866)	11,438	(1,918)
Net cash related to discontinued operations, net of tax benefit	—	—	—	—	25

(1) Reflects impact of the sale of the international rights to the Natural American Spirit brand that occurred on January 13, 2016.

(2) Reflects impact of the Lorillard merger and the Lorillard Divestiture.

(3) Net sales and cost of products sold exclude excise taxes of $2,065 million and $2,150 million for the six months ended June 30, 2017 and 2016, respectively, and $4,343 million, $4,209 million, and $3,625 million for the years ended December 31, 2016, 2015, and 2014, respectively.

(4) Reflects sales to the BAT Group.

(5) Includes NPM Adjustment credits of $92 million and $189 million for the six months ended June 30, 2017 and 2016, respectively and $390 million, $297 million and $345 million for the years ended December 31, 2016, 2015 and 2014, respectively.

(6) Includes a reclassification due to the adoption of Accounting Standards Updates 2015-17 and 2015-03 and was reduced by $1.0 billion and $704 million as of December 31, 2015 and 2014, respectively.

(7) Includes a reclassification due to the adoption of Accounting Standards Updates 2015-17 and 2015-03 and was reduced by $1.1 billion and $415 million as of December 31, 2015 and 2014 respectively.

(8) Includes a reclassification due to the adoption of Accounting Standards Update 2015-03 and was reduced by $92 million and $31 million as of December 31, 2015 and 2014, respectively.

RATIO OF EARNINGS TO FIXED CHARGES

The following table presents BAT's historical and pro forma (as if the merger had occurred on January 1, 2016) ratio of earnings to fixed charges for the periods indicated.

	Pro Forma as if the merger had occurred on January 1, 2016 For the Year Ended December 31(2),	For the Six Months Ended June 30,		For the Years Ended December 31,	
	2016	2017	2016	2016	2015
		(unaudited)			
Ratio of earnings to fixed charges(1)	21.5	7.7	9.2	9.0	9.2

(1) Based on rounded thousands.

(2) The unaudited pro forma condensed combined financial information of BAT for the year ended December 31, 2016 gives effect to the merger, including the borrowings under the acquisition facility and excluding the offering of the Notes. See "*BAT Unaudited Pro Forma Condensed Combined Financial Information*".

For purposes of calculating this ratio, "earnings" consist of profit before taxation and share of post-tax results of associates and joint ventures, fixed charges, adjusted for non-controlling interests, and including dividends from affiliates accounted for by the equity method. "Fixed charges" consist of finance costs, excluding loss on bond redemption, and the interest portion of rental expense.

The following table presents RAI's ratio of earnings to fixed charges for the periods indicated.

	For the Six Months Ended June 30,		For the Years Ended December 31,	
	2017	2016	2016	2015
	(unaudited)			
Ratio of earnings to fixed charges(1)	9.5	22.2	16.3	12.0

(1) Based on rounded thousands.

For purposes of calculating this ratio, "earnings" consist of income from continuing operations before equity earnings, income taxes and fixed charges. "Fixed charges" consist of interest on indebtedness, amortization of debt issuance costs and the interest portion of rental expense.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS OF BAT

The following discussion and analysis of the BAT Group's financial condition and results of operations is based on and should be read in conjunction with the BAT Group's consolidated financial statements and unaudited condensed consolidated financial statements, included in this Offering Memorandum. The BAT Group's consolidated financial statements and the BAT Group's unaudited condensed consolidated financial statements have been prepared in accordance with IFRS, which may differ in material respects from generally accepted accounting principles in other jurisdictions, including the United States. The consolidated financial statements as of and for the years ended December 31, 2016, 2015 and 2014 have been audited. The condensed consolidated financial statements as of June 30, 2017 and for the six months ended June 30, 2017 and 2016 are unaudited. See further discussion at "Presentation of Financial Information and Other Data".

This discussion and analysis contains certain forward-looking statements which, although based on assumptions that the BAT Group considers reasonable, are subject to risks and uncertainties that could cause actual events or conditions to differ materially from those expressed or implied herein. Factors that could cause or contribute to such differences include, but are not limited to, those discussed below and elsewhere in this Offering Memorandum, see particularly "Forward-Looking Statements" and "Risk Factors".

The financial information and related discussion and analysis contained in this section are presented in pounds sterling, and many of the amounts and percentages have been rounded for convenience of presentation.

Overview

BAT is the parent holding company of the BAT Group, a global tobacco and next generation products group with brands sold in over 200 markets. According to the BAT Group's internal estimates, the BAT Group is a market leader in more than 55 countries by volume, producing the cigarette chosen by one in eight of the world's one billion smokers. The BAT Group, excluding the BAT Group's associated undertakings, is organized into four regions: Asia-Pacific, Americas, Western Europe and EEMEA.

In 2016, the BAT Group sold approximately 665 billion cigarettes (excluding sales of its associates) of which approximately 630 billion cigarettes were produced by 44 factories in 42 countries. In 2016, the BAT Group's five global drive brands accounted for 49% of the BAT Group's total cigarette volume. In the six months ended June 30, 2017, the BAT Group sold approximately 314 billion cigarettes. The BAT Group's range of products covers all segments, from value-for-money to premium with a portfolio of international, regional and local tobacco brands to meet a broad array of adult tobacco consumer preferences wherever the BAT Group operates. The BAT Group is investing in building a portfolio of innovative new types of tobacco and nicotine products alongside its traditional tobacco business. These next generation products include vapor products (such as e-cigarettes) and tobacco heating products.

The BAT Group manages a globally integrated supply chain and the BAT Group's products are distributed to retail outlets worldwide. During 2016, the BAT Group employed around 50,000 people worldwide.

Key Factors Affecting Results of Operations

The BAT Group believes that the following factors have had and will continue to have a material effect on its results of operations and financial condition. In addition, important factors that could cause the BAT Group's actual operations or financial conditions to differ materially from those expressed or implied below, include, but are not limited to, factors described under "*Risk Factors*".

Business Combinations and Acquisitions

The BAT Group's growth strategy is to increase volume and share of the global tobacco market through organic growth and mergers and acquisitions where it makes financial and strategic sense. During 2016 and 2015, the BAT Group's financial condition and the comparability of results of operations between years have been affected by business combinations, particularly Souza Cruz and TDR, and may be so affected in the future by these and future business combinations.

- On July 25, 2017, the BAT Group completed the acquisition of the remaining 57.8% of RAI not already owned by the BAT Group for a consideration of £41.7 billion. RAI shareholders received, for each share of RAI common stock, $29.44 in cash, without interest, and 0.5260 BAT ordinary shares which are represented by BAT ADSs listed on the New York Stock Exchange.
- In April 2016, the BAT Group announced it had acquired Ten Motives, a UK based e-cigarette business with particular strength in traditional grocery and convenience channels. The fair value of the consideration payable was £56 million, of which £6 million is contingent on post-acquisition targets being met.

- During 2015, the BAT Group invested £1.7 billion to acquire the shares it did not already own in its Brazilian subsidiary, Souza Cruz, and de-listed the company. Following a public auction in October 2015, the BAT Group acquired sufficient shares to cancel Souza Cruz's registration as a publicly listed company, with a total shareholding of 99.1%. The compulsory acquisition of the remaining minority shares was approved on February 5, 2016, with Souza Cruz becoming a wholly owned subsidiary at that date.
- In November 2015, the BAT Group acquired 100% of Blue Nile Cigarette Company Limited, a tobacco manufacturing and distribution company in the Republic of Sudan. The fair value of the consideration payable was £45 million, of which £8 million was contingent on achievement of certain post-acquisition targets.
- In September 2015, the BAT Group announced that it had signed a conditional agreement to acquire 100% of the CHIC Group, a leading vapor product business in Poland. The transaction was completed on December 30, 2015. The fair value of the consideration payable was £82 million, of which £30 million was contingent on achievement of certain post-acquisition targets.
- In September 2015, the BAT Group completed the acquisition of TDR d.o.o., a cigarette manufacturer in Central Europe, and other tobacco and retail assets, referred to as TDR, from Adris Grupa d.d. for a total enterprise value of €550 million.

Industry Trends Affecting Revenue and Profit

The BAT Group's revenue and profit have been and will continue to be affected by various industry trends including tobacco consumption rates, regulatory developments, taxation, litigation, illicit trade, macro-economic challenges and competitive dynamics. Changes in these factors could adversely restrict or otherwise affect BAT's business. Please refer to "*Business*" for a fuller description of the industry, the competitive environment and the key laws and regulations to which the BAT Group's operations are subject.

According to Euromonitor International and the BAT Group's internal estimates, the global cigarette industry sells around 5,450 billion cigarettes each year and the retail value of the global tobacco market (including cigarettes, cigars, cigarillos, smoking tobacco, smokeless tobacco and vapor products) for 2016 was estimated at $785 billion. Since 1995, the world market for cigarettes has grown, predominantly due to growth in China, which has offset the reducing volume of cigarettes in the rest of the world, especially in developed markets, such as Western Europe. Over the coming years, the BAT Group expects volumes of cigarettes outside China to continue to decline as a lower percentage of the total adult population will choose to smoke cigarettes and individual smokers will consume fewer cigarettes; these dynamics will be partially offset by the impact of population growth.

In 2016, the four biggest international manufacturers, outside of China, India and the United States, according to the BAT Group's internal estimates, were Philip Morris International with a share of the global market excluding China, India and the United States of approximately 31%, the BAT Group (excluding associates) with approximately 25%, Japan Tobacco with approximately 19% and Imperial Brands with approximately 10%, based on sales by volume. Collectively, these four players held around 41% of the global market, or approximately 84% of the market outside of China, India and the United States. According to Euromonitor International, China accounts for approximately 45% of global cigarette volume and is the world's largest cigarette market. The international tobacco companies have a very small presence in the Chinese market, where the industry is state-owned. According to Euromonitor International, India accounts for approximately 1.5% of global cigarette volume and ITC accounts for approximately 79% of India's market share. The BAT Group has an approximate 30% interest in ITC. According to Euromonitor International, the United States accounts for approximately 5% of global cigarette volume. For 2016, the RAI Group accounted for approximately 34% of the United States' cigarette market share, according to MSAi. The BAT Group had an approximate 42% interest in RAI, prior to the merger. The global tobacco industry operates in a challenging environment. The BAT Group competes primarily on the basis of product quality, brand recognition brand loyalty, taste, innovation, packaging, service, marketing, advertising and retail price. The size of the global cigarette market is impacted by a number of factors, including increased regulation, litigation, rising excise rates on its products and illicit trade.

The tobacco industry is also exposed to significant product liabilities litigation, including in the United States. The BAT Group anticipates that it will continue to be exposed to new litigation. The BAT Group's consolidated results of operations, cash flows and financial position could be materially affected in a particular reporting period by an unfavorable outcome or settlement of certain pending or future litigation. See *"Business — Legal Proceedings"*.

Tobacco products are subject to substantial duty, excise and other taxes in most markets in which the BAT Group operates. Increases to duty, excise and other taxes affect the size of tobacco markets. Significant and sustained increases in taxes in markets where tobacco prices are already high may lead adult tobacco consumers to switch to cheaper brands. This can lead to the growth in sales of lower margin products and decreases in sales of higher margin products. Additionally, increases in tobacco taxes can lead to adult tobacco consumers rejecting legitimate tax paid products and switching to products from illegal sources.

Trafficking of tobacco products includes the trade in counterfeit products, smuggled genuine products, including "illicit whites" (also known as "made for smuggling brands"), and locally manufactured products on which applicable taxes are evaded. Illicit trade remains a key challenge for the legitimate tobacco industry. Illicit trade is driven by many factors, including tax-driven price increases, weak criminal penalties, poor enforcement of border controls, weak laws, corruption, loosely regulated free trade zones, a less rigorous approach to intellectual property rights protection and the use of the internet as a medium of trading. Euromonitor International estimates that approximately 456 billion cigarettes per year are smuggled, manufactured illegally or counterfeited.

The BAT Group believes that quality and innovation will play an increasing role in delivering market share, as tobacco companies operate in a highly competitive marketplace. This involves cigarette innovations such as capsule products, additive-free products, tube filters and slims. Substantial investments have also been made in developing next generation products.

Foreign Exchange Movements

The BAT Group's results are impacted by currency exposures arising from the translation of profits earned in foreign currency subsidiaries and associates and joint ventures into the BAT Group's reporting currency, the pound sterling. Also, in order to prepare its consolidated financial information, the BAT Group translates the net assets of foreign currency subsidiaries and associates into the pound sterling. The BAT Group's primary financial statement translation exposures are to the U.S. dollar, Canadian dollar, euro, Danish krone, Swiss franc, South African rand, Russian ruble, Brazilian real, Australian dollar, Malaysian ringgit, Singaporean dollar and Indian rupees. Additionally, the BAT Group's exposure also arises from foreign currency denominated trading transactions undertaken by subsidiaries and forecast dividend flows from subsidiaries.

As a result of the global nature of the BAT Group's business, the BAT Group expects to continue to be exposed to foreign currency fluctuations.

Restructuring and Integration Costs

Profit for the six-month periods ended June 30, 2017 and 2016 and for the years 2016, 2015 and 2014 was impacted by initiatives to improve effectiveness and efficiency as a globally integrated enterprise, including the implementation of a new operating model, which includes revised organization structures, standardized processes and shared back-office services underpinned by a global single instance of SAP. These initiatives also include a review of manufacturing operations, supply chain overheads and indirect costs, organizational structure and systems and software used.

In the six months ended June 30, 2017, restructuring and integration costs were £133 million, compared to £161 million in the six months ended June 30, 2016. In 2016, restructuring and integration costs were £603 million, compared to £367 million in 2015 and £452 million in 2014. Restructuring and integration costs have principally related to the implementation of the new operating model and the cost of initiatives in respect of permanent headcount reductions and permanent employee benefit reductions in the BAT Group. In the six months ended June 30, 2017, restructuring and integration costs include advisor fees and costs incurred related to the acquisition of the remaining shares in RAI not already owned by the BAT Group, as well as the factory closure and downsizing activities in Germany. In 2016, the costs also cover factory closure and downsizing activities in Germany, Malaysia and Brazil, certain exit costs and asset write-offs related to the change in approach to the commercialization of VOKE, an innovative nicotine inhaler product licensed as a medicine, uncertainties surrounding regulatory changes and restructurings in Japan and Australia. In 2015, the costs included those related to factory closure and downsizing activities in Australia, acquisition related costs, and restructurings in Indonesia, Canada, Switzerland and Germany. In 2014, these costs included those related to factory closure and downsizing activities in Australia, Colombia and the Democratic Republic of Congo, and restructurings in Argentina, Indonesia, Canada, Switzerland and Germany.

Discussion of Principal Income Statement Items

Revenue

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

Raw Materials and Consumables Used

Raw materials and consumables used include, among other things, tobacco leaf, paper, filters and other packaging materials, and the freight costs of transporting these materials. In the six months ended June 30, 2017 and 2016, these costs represented 24.4% and 24.4% of revenue, respectively. In the years 2016, 2015 and 2014, these costs represented 25.6%, 24.5% and 22.1% of revenue, respectively.

Employee Benefit Costs

Employee benefit costs include wages and salaries, social security costs, pension and other retirement benefit costs and share based payments. In the six months ended June 30, 2017 and 2016, these costs represented 14.8% and 15.5% of revenue, respectively. In the years 2016, 2015 and 2014, these costs represented 15.4%, 15.6% and 15.7% of revenue, respectively.

Other Operating Expenses

Other operating expenses consist of other costs not separately disclosed on the BAT Group's income statement and include such items as marketing spend and other costs of secondary supply chains. In the six months ended June 30, 2017 and 2016, these costs represented 22.9% and 23.9% of revenue, respectively. In the years ended 2016, 2015 and 2014, these costs represented 24.8%, 25.0% and 27.6% of revenue, respectively.

Results of Associates and Joint Ventures

Associates historically principally comprised RAI and ITC. In 2016, the BAT Group's interest in ITC decreased from approximately 30.1% in 2015 to approximately 29.9% in 2016 as a result of ITC issuing ordinary shares under its employee share option scheme. In the six months ended June 30, 2017, the BAT Group's interest in ITC decreased to approximately 29.8%. In 2016, the BAT Group's interest in RAI remained at approximately 42.2%, and after the completion of the merger on July 25, 2017, RAI became an indirect, wholly owned subsidiary of BAT. The BAT Group's ownership interest ITC means the BAT Group may be affected by its business and financial performance, as it is subject to tobacco-related industry and business risks similar to those the BAT Group faces.

Key Non-IFRS Measures

See "*Presentation of Financial Information and Other Data — Non-IFRS Measures*"

Consolidated Results of Operations for the BAT Group

The discussion of the BAT Group's consolidated results from operations is based on its historical results. Except as set out below, the financial data discussed in this section for 2016, 2015 and 2014 and for the six months ended June 30, 2017 and 2016 have been prepared in accordance with IFRS. The discussion should be read in conjunction with *"Summary Historical Consolidated Financial Data of BAT", "Presentation of Financial Information and Other Data"* and *"Business"*.

	Six Months Ended June 30,[1]		Year Ended December 31,[1]		
	2017	2016	2016	2015	2014
			(£ millions)		
Revenue[2]	7,717	6,669	14,751	13,104	13,971
Raw materials and consumables used	(1,881)	(1,630)	(3,777)	(3,217)	(3,088)
Changes in inventories of finished goods and work in progress	(59)	8	44	184	58
Employee benefit costs	(1,144)	(1,034)	(2,274)	(2,039)	(2,194)
Depreciation, amortization and impairment costs	(346)	(253)	(607)	(428)	(523)
Other operating income	55	49	176	225	178
Other operating expenses	(1,768)	(1,596)	(3,658)	(3,272)	(3,856)
Profit from operations	2,574	2,213	4,655	4,557	4,546
Net finance (costs)/income	(325)	(233)	(637)	62	(417)
Share of post-tax results of associates and joint ventures	778	1,446	2,227	1,236	719
Profit before taxation	3,027	3,426	6,245	5,855	4,848
Taxation on ordinary activities	(680)	(685)	(1,406)	(1,333)	(1,455)
Profit for the year	2,347	2,741	4,839	4,522	3,393
Adjusting items in profit from operations	267	239	825	435	857
Adjusted profit from operations[3]	2,841	2,452	5,480	4,992	5,403

Note:

(1) The above historical financial data has been extracted from the BAT Group's consolidated financial statements and the BAT Group's unaudited condensed consolidated financial statements included in this Offering Memorandum. The historical financial data for the six months ended June 30, 2017 and 2016 is unaudited. See further discussion at "*Presentation of Financial Information and Other Data*".

(2) Revenue is net of duty, excise and other taxes of £32,136 million, £27,896 million and £28,535 million in the years 2016, 2015 and 2014, respectively and of £17,377 million and £14,364 million for the six months ended June 30, 2017 and 2016, respectively.

(3) Adjusted profit from operations is a non-IFRS measure. See "*Summary Historical Consolidated Financial Data of BAT*" for additional information about adjusted profit from operations, as well as a reconciliation to profit from operations.

Volume by Brand and Other Measures

In addition to revenue and the other measures discussed in this Offering Memorandum, BAT Group management focuses on volume as a key measure to evaluate performance. Volume is an unaudited operating measure and is calculated as the total global cigarette volume of the BAT Group's brands sold by its subsidiaries. The BAT Group believes that volume is a measure commonly used by analysts and investors in the industry. Accordingly, this information has been disclosed to permit a more complete analysis of the BAT Group's operating performance.

	Year Ended December 31,[1]		
	2016	2015	2014
Dunhill	57	59	55
Kent	66	66	64
Lucky Strike	36	32	31
Pall Mall	92	92	92
Rothmans	73	52	36
Total global drive brands	324	301	278
Total other	341	362	389
Total volume	**665**	**663**	**667**
Organic volume[2]	658	661	667

Note:

(1) Data relating to volume for the years 2016, 2015 and 2014 is unaudited and has been extracted from the BAT Group's marketing records.

(2) Organic volume excludes contributions from TDR in 2016 and 2015 and Blue Nile in 2016. The BAT Group also uses market share to evaluate its performance. The BAT Group evaluates changes in its retail market share, or market share, in its key markets for tobacco products, based on the latest available data from a number of internal and external sources. Key markets consist of approximately 40 territories across all geographical segments, and represent approximately 80% of the BAT Group's global volume. Growth in these markets is largely driven by the global drive brands. The BAT Group also highlights drivers for change in specific markets (e.g., volume or market share). For next generation products, the BAT Group monitors its performance in select countries (e.g., UK, Germany, Italy) based upon category retail market share, based on the latest available data from a number of internal and external sources. In addition, the BAT Group's performance is affected by global pricing, which is impacted by discounts, terms of credit with customers, excise taxes

and other competitive, market-driven and regulatory factors. In certain markets, the BAT Group has experienced increases or decreases in average prices resulting from changes in product mix, also referred to as price mix. The BAT Group believes that pricing and market share are measures commonly used by analysts and investors in the industry.

The Six Months Ended June 30, 2017 Compared with the Six Months Ended June 30, 2016

Revenue

Revenue increased by £1,048 million, or 15.7%, from £6,669 million for the six months ended June 30, 2016 to £7,717 million for the six months ended June 30, 2017, driven by translational foreign exchange tailwind due to the relative weakness in the pound sterling. At constant rates of exchange revenue would have increased by 3.5% to £6,901 million. Over the same period, duty, excise and other taxes paid increased by £3,013 million, or 21.0%, from £14,364 million for the six months ended June 30, 2016 to £17,377 million for the six months ended June 30, 2017.

In the six months ended June 30, 2017, overall volume decreased by 18 billion, or 5.6%, from 332 billion for the six months ended June 30, 2016 to 314 billion for the six months ended June 30, 2017. Market share in the BAT Group's key markets increased by 30 basis points, or bps. Global drive brands volume decreased by 1.3% while global drive brands market share increased by 50 basis points in the six months ended June 30, 2017.

In the six months ended June 30, 2017, volume of Dunhill declined by 4.5%, as the migration in Croatia and growth in GCC, Romania and West Africa was offset by lower volume driven by market contraction and down-trading in Indonesia, Malaysia and South Korea. Dunhill market share was down 10 bps, although recovered in the three months ended June 30, 2017 with an improving market share in Malaysia, Brazil and South Africa. Kent's volume in the six months ended June 30, 2017 decreased by 1.6%, due to reductions in Iran, Russia and Japan, which were offset by higher volume in Turkey, Kazakhstan and Brazil (due to the migration from Free). Kent's market share was up 15 bps. Lucky Strike, the BAT Group's original American brand, grew market share by 20 bps and volume increased by 12.4% in the six months ended June 30, 2017, with growth in Indonesia, Spain and Italy, more than offsetting lower volume in Argentina, Japan and Russia. In the six months ended June 30, 2017, Pall Mall's volume decreased by 9.6%, principally due to market contraction in Pakistan, which was partially offset by growth in Poland, GCC, Romania, Mexico and Ukraine. Pall Mall market share was up 10 bps. In the six months ended June 30, 2017, Rothmans volume was up by 6.2%, driven by Russia, Nigeria, Serbia, Algeria and Poland offsetting lower volume in Kazakhstan, Ukraine and Egypt. Rothmans market share was up 15 bps.

Raw Materials and Consumables Used

Raw materials and consumables used increased by £251 million, or 15.4%, from £1,630 million in the six months ended June 30, 2016 to £1,881 million in the six months ended June 30, 2017. Raw materials and consumables used as a percentage of revenue remained constant at 24.4% in the six months ended June 30, 2017 from 24.4% in the six months ended June 30, 2016.

Employee Benefit Costs

Employee benefit costs increased by £110 million, or 10.6%, from £1,034 million in the six months ended June 30, 2016 to £1,144 million in the six months ended June 30, 2017. As a percentage of revenue, these costs represented 14.8% in the six months ended June 30, 2017 and 15.5% in the six months ended June 30, 2016.

Depreciation, Amortization and Impairment Costs

Depreciation, amortization and impairment costs increased by £93 million, or 36.8%, primarily due to amortization of trademarks and similar intangibles arising from the acquisition of Bulgartabac Holdings and previous business combinations, including TDR, Bentoel, Tekel and ST.

Other Operating Expenses

Other operating expenses increased by £172 million, or 10.8%, from £1,596 million for the six months ended June 30, 2016 to £1,768 million for the six months ended June 30, 2017. As a percentage of revenue, these costs represented 22.9% in the six months ended June 30, 2017 and 23.9% in the six months ended June 30, 2016.

Profit from Operations

As a result of the above, profit from operations increased by £361 million, or 16.3%, from £2,213 million for the six months ended June 30, 2016 to £2,574 million for the six months ended June 30, 2017.

Net Finance Costs/Income

Net finance costs increased by £92 million, from £233 million for the six months ended June 30, 2016 to £325 million for the six months ended June 30, 2017. This movement was impacted by the devaluation of the pound sterling on the reported results. In addition, net finance costs were impacted by adjusting items, including hedge ineffectiveness of £10 million, interest related to Franked Investment Income Group Litigation Order (FII GLO) of £12 million and costs related to the merger of £27 million. For more information on adjusting items in net finance costs/income, see note 3 to the BAT Group's unaudited condensed consolidated financial statements included in this Offering Memorandum.

Results of Associates and Joint Ventures

Associates were historically principally comprised of RAI and ITC. The BAT Group's share of the post-tax results of associates and joint ventures, included at the pre-tax profit level under IFRS, was £778 million in the six months ended June 30, 2017, compared to £1,446 million in the six months ended June 30, 2016. This decrease of £668 million, or 46.2%, was principally driven by the one-off contribution from the sale by RAI of the international rights to Natural American Spirit in 2016. For more information on adjusting items in the results of associates and joint ventures, see note 3 to the BAT Group's unaudited condensed consolidated financial statements included in this Offering Memorandum.

Taxation on Ordinary Activities

Taxation on ordinary activities was £680 million in the six months ended June 30, 2017, compared to £685 million in the six months ended June 30, 2016. The BAT Group's effective tax rate was 22.5% in the six months ended June 30, 2017, compared to 20.0% in the six months ended June 30, 2016, both of which were affected by the inclusion of the share of associates' post-tax profit in the BAT Group's pre-tax results and by adjusting items. Excluding these, the underlying tax rate for subsidiaries was 28.4% and 29.9% in the six months ended June 30, 2017 and the six months ended June 30, 2016, respectively. The adjusting tax item includes credits of £48 million for the six months to June 30, 2017, £29 million for the six months to June 30, 2016 and £128 million for the year ended December 31, 2016 in respect of the tax on adjusting items recognized in operating profit and net finance costs. In 2016, the BAT Group's share of the gain on the sale of the international rights to Natural American Spirit by RAI to Japan Tobacco International was recognized as an adjusting item by the BAT Group. Accordingly, the additional deferred tax charge on the potential distribution of these undistributed earnings of £58 million for the six months to June 30, 2016 and £61 million for the year ended December 31, 2016 has also been treated as adjusting. For more information on adjusting items in taxation, see note 3 to the BAT Group's unaudited condensed consolidated financial statements included in this Offering Memorandum.

Profit for the Period

As a result of the above, profit for the period decreased by £394 million, or 14.4% from £2,741 million for the six months ended June 30, 2016 to £2,347 million for the six months ended June 30, 2017.

Adjusting Items in Profit from Operations

In the six months ended June 30, 2017, adjusting items in profit from operations increased by £28 million from £239 million in the six months ended June 30, 2016 to £267 million in the six months ended June 30, 2017, or 11.7%. This increase was driven primarily by an increase in amortization of trademarks and similar intangibles.

Acquisitions including Bulgartabac Holdings, TDR, Bentoel, Tekel and ST resulted in the capitalization of trademarks and similar intangibles which are amortized over their expected useful lives, which do not exceed 20 years. The amortization charge of £134 million (the six months ended June 30, 2016: £58 million) is included in depreciation, amortization and impairment costs in profit from operations.

2016 Compared with 2015

Revenue

Revenue increased by £1,647 million, or 12.6%, from £13,104 million for 2015 to £14,751 million for 2016, driven by improved pricing, with price mix increasing to over 6%, and reflecting the positive currency effects resulting from the relative weakness of the pound sterling. At constant rates of exchange revenue would have increased by 6.9% to £14,008 million. Over the same period, duty, excise and other taxes paid increased by £4,240 million, or 15.2%, from £27,896 million for 2015 to £32,136 million for 2016.

In 2016, overall volume increased by 2 billion, or 0.2%, from 663 billion for 2015 to 665 billion for 2016, with the industry estimated to be down by 3.0%. Market share in the BAT Group's key markets increased by over 50 basis points, or bps. Global drive brands volume increased by 7.5% in 2016, driven by increased sales of Rothmans and Lucky Strike. This increase was partially offset by a volume decrease for brands other than the global drive brands of 5.8%.

In 2016, volume of Dunhill declined by 3.3%, with market share flat, driven mainly by industry declines in Malaysia and Brazil, more than offsetting growth in South Korea and continued growth in Indonesia. Kent's 2016 volume increased by 1.0%, due to growth in Chile, Turkey, Japan and Russia. Kent's market share was up 10 bps. Lucky Strike, the BAT Group's original American brand, saw an increase of 13.5% to 36 billion in 2016, with growth in Indonesia, Colombia, Egypt, France, Croatia and Italy, more than offsetting lower volume in Argentina and Russia. Lucky Strike market share grew 10 bps. In 2016, Pall Mall volume increased by 0.1% and is the BAT Group's leading brand in terms of volume, as growth in Venezuela, Poland, Iran, Mexico and Romania more than offset reductions in Pakistan and the migration to Rothmans in Italy. Pall Mall market share was up 10 bps. In 2016, Rothmans volume was up by 36.9% or 21 billion, driven by growth in Russia, Ukraine, Italy, Nigeria, Turkey and South Korea. Rothmans market share was up 70 bps.

Raw Materials and Consumables Used

Raw materials and consumables used increased by £560 million, or 17.4%, from £3,217 million in 2015 to £3,777 million in 2016, impacted by the increase in volume and changes in foreign exchange. Raw materials and consumables used as a percentage of revenue increased to 25.6% in 2016 from 24.5% in 2015.

Employee Benefit Costs

Employee benefit costs increased by £235 million, or 11.5%, from £2,039 million in 2015 to £2,274 million in 2016. The increase is principally the result of translational foreign exchange movements and adjusting items associated with various reorganization activities undertaken within the BAT Group during 2016. As a percentage of revenue, these costs represented 15.4% in 2016 and 15.6% in 2015.

Depreciation, Amortization and Impairment Costs

Depreciation, amortization and impairment costs increased by £179 million, or 41.8%, primarily due to trademarks and similar intangibles, where amortization and impairment increased by £84 million, from £65 million in 2015 to £149 million in 2016, including the impact of a £33 million impairment. Acquisitions including Ten Motives, CHIC Group, TDR, Bentoel, Tekel and Skandinavisk Tobakskompagni A/S, referred to as ST, resulted in the capitalization of trademarks and similar intangibles which are amortized over their expected useful lives, which do not exceed 20 years. The amortization and impairment charge for trademarks and similar intangibles of £149 million (2015: £65 million) is included in depreciation, amortization and impairment costs in profit from operations. The increase was also driven by depreciation and impairment of property, plant and equipment, which increased by £103 million, from £274 million in 2015 to £377 million in 2016, impacted by the depreciation of acquired property, plant and equipment. The increase in depreciation, amortization and impairment is partially offset by a decrease of £8 million in amortization and impairment of other intangibles.

Other Operating Expenses

Other operating expenses increased by £386 million, or 11.8%, from £3,272 million for 2015 to £3,658 million for 2016 due to increases in certain overhead costs and the impact of foreign exchange. As a percentage of revenue, these costs represented 24.8% in 2016 and 25.0% in 2015.

Profit from Operations

As a result of the above, profit from operations increased by £98 million, or 2.2%, from £4,557 million for 2015 to £4,655 million for 2016.

Net Finance Costs/Income

Net finance costs increased by £699 million, from net finance income of £62 million for 2015 to net finance costs of £637 million for 2016. This movement was impacted by an increase in finance costs related to fair value changes on derivative financial instruments and hedged items of £213 million. In addition, net finance costs were impacted by adjusting items, including a deemed gain related to the investment in RAI of £601 million in 2015 that did not recur in 2016. For more information on adjusting items in net finance costs/income, see note 4(b) to the BAT Group's consolidated financial statements included in this Offering Memorandum.

Results of Associates and Joint Ventures

Associates were historically principally comprised of RAI and ITC. The BAT Group's share of the post-tax results of associates and joint ventures, included at the pre-tax profit level under IFRS, was £2,227 million in 2016, compared to £1,236 million in 2015. This increase of £991 million, or 80.3%, was principally driven by an improvement in the results of RAI, whose profit on ordinary activities before taxation increased by £2,861 million, and an adjusting item resulting from RAI's gain on the sale of the international rights to Natural American Spirit in 2016, of which BAT's share was £941 million (net of tax), compared to 2015, when BAT's share of RAI's gain on divestiture was £371 million (net of tax). For more information on adjusting items in the results of associates and joint ventures, see note 5(a) to the BAT Group's consolidated financial statements included in this Offering Memorandum.

Taxation on Ordinary Activities

Taxation on ordinary activities was £1,406 million in 2016, compared to £1,333 million in 2015. The BAT Group's effective tax rate was 22.5% in 2016, compared to 22.8% in 2015, both of which were affected by the inclusion of the share of associates' post-tax profit in the BAT Group's pre-tax results and by adjusting items, notably the deemed gain related to the investment in RAI of £601 million in 2015, discussed above. Excluding these, the underlying tax rate for subsidiaries was 29.8% and 30.5% in 2016 and 2015, respectively. The BAT Group's share of post-tax results of associates and joint ventures was £2,227 million in 2016 and £1,236 million in 2015. Adjusting items in taxation were £61 million and £22 million in 2016 and 2015, respectively, resulting from additional deferred tax charge on potential distributions of undistributed earnings from the BAT Group's share of the gain on divestitures of intangibles and other assets by RAI. For more information on adjusting items in taxation, see note 6(d) to the BAT Group's consolidated financial statements included in this Offering Memorandum.

Profit for the Year

As a result of the above, profit for the year increased by £317 million, or 7.0% from £4,522 million for 2015 to £4,839 million for 2016.

Adjusting Items in Profit from Operations

In 2016, adjusting items in profit from operations increased by £390 million from £435 million in 2015 to £825 million in 2016, or 89.7%. This increase was driven primarily by a £236 million increase in restructuring and integration costs. In addition to costs related to implementation of a new operating model and the cost of initiatives in respect of permanent headcount reductions and permanent employee benefit reductions in both 2016 and 2015, restructuring and integration costs in 2016 included factory closure and downsizing activities in Germany, Malaysia and Brazil, certain exit costs and asset write-offs related to the change in approach to the commercialization of VOKE (as announced on January 5, 2017), uncertainties surrounding regulatory changes and restructurings in Japan and Australia. In 2015, restructuring and integration costs also included factory closure and downsizing activities in Australia, certain costs related to the acquisitions undertaken (including TDR in Croatia) and restructurings in Indonesia, Canada, Switzerland and Germany. In addition to this increase in restructuring and integration costs, adjusting items in profit from operations were impacted by an £84 million increase in amortization and impairment of trademarks and similar intangibles. Acquisitions including Ten Motives, CHIC, TDR, Bentoel, Tekel and ST resulted in the capitalization of trademarks and similar intangibles which are amortized over their expected useful lives, which do not exceed 20 years. The amortization and impairment charge of £149 million (2015: £65 million) is included in depreciation, amortization and impairment costs in profit from operations.

2015 Compared with 2014

Revenue

Revenue decreased by £867 million, or 6.2%, from £13,971 million for 2014 to £13,104 million for 2015. The BAT Group's results were impacted by the adverse movement of a number of key currencies and this is reflected in an adverse translational exchange rate movement. Revenue would have been up 5.4% at £14,720 million at constant rates of exchange, driven by a price mix increase to 5.9%. Over the same period, the amount of duty, excise and other taxes paid decreased by £639 million, or 2.2%, from £28,535 million for 2014 to £27,896 million for 2015.

In 2015, overall volume declined by 4 billion, or 0.5%, from 667 billion for 2014 to 663 billion for 2015, with the industry estimated to have declined by approximately 3%, based on the BAT Group's internal estimates. Market share in the BAT Group's key markets increased by over 40 bps. Global drive brands volume grew by 8.5% in 2016 to 301 billion. The BAT Group's other brands experienced a decrease in volume of 6.9%.

In 2015, Dunhill volume increased by 6.0% to 59 billion, with market share higher by 30 bps, driven mainly by increased volume in Indonesia, Brazil and South Africa, offsetting lower volume in South Korea, Malaysia and Russia. Kent's volume in 2015 was 66 billion, up by 3.3% as volume growth in Iran, Turkey, Japan and Chile was partially offset by lower volume in Russia and Ukraine. Kent's market share was flat in 2015. In 2015, volume for Lucky Strike grew by 3.7%, up to 32 billion, with increases in Belgium, France and Chile more than offsetting decreases in Russia and Argentina. Lucky Strike market share grew 10 bps in 2015. In 2015, volume for Pall Mall increased by 0.4% at 92 billion, as growth in Pakistan, Venezuela, Poland and Mexico was partly offset by the effect of the brand migration to Rothmans in Italy. Pall Mall market share was up 10 bps. In 2015, Rothmans had growth of 46.5%, with volume of 52 billion, led by increases in Russia, Ukraine, Turkey, Italy, Kazakhstan, Australia, Algeria and the United Kingdom. Rothmans market share was up 70 bps during 2015.

Raw Materials and Consumables Used

Raw materials and consumables used increased by £129 million, or 4.2%, from £3,088 million for 2014 to £3,217 million for 2015, impacted by increasing costs and foreign exchange movements. Raw materials and consumables used as a percentage of revenue increased from 22.1% for 2014 to 24.5% for 2015.

Employee Benefit Costs

Employee benefit costs decreased by £155 million, or 7.1%, from £2,194 million for 2014 to £2,039 million for 2015. This decrease was the result of the impact of exchange rate movements, local remuneration agreements, varying employment costs and a reduction in headcount across end markets and regions. Employee benefit costs as a percentage of revenue decreased slightly from 15.7% for 2014 to 15.6% for 2015.

Depreciation, Amortization and Impairment Costs

Depreciation, amortization and impairment costs decreased by £95 million, or 18.2%, from £523 million for 2014 to £428 million for 2015. This was primarily driven by a decrease in depreciation and impairment of property, plant and equipment of £122 million, from £396 million in 2014 to £274 million in 2015. This decrease was partially offset by a £27 million increase in amortization and impairment of intangible assets.

Other Operating Expenses

Other operating expenses decreased by £584 million, or 15.1%, from £3,856 million for 2014 to £3,272 million for 2015, impacted by movements in foreign exchange. Other operating costs as a percentage of revenue decreased from 27.6% for 2014 to 25.0% for 2015.

Profit from Operations

As a result of the above, profit from operations increased by £11 million, or 0.2%, from £4,546 million for 2014 to £4,557 million for 2015.

Net Finance Costs/Income

Net finance costs decreased by £479 million, or 114.9% from net finance cost of £417 million in 2014 to net finance income of £62 million in 2015. This movement was impacted by adjusting items in 2015, including a deemed gain related to the investment in RAI of £601 million, as well as £104 million of costs in relation to the funding of the acquisition of the shares not owned by the BAT Group in Souza Cruz and investment in RAI. For more information on adjusting items in net finance costs/income, see note 4(b) to the BAT Group's consolidated financial statements included in this Offering Memorandum.

Results of Associates and Joint Ventures

Associates were historically principally comprised of RAI and ITC. The BAT Group's share of the post-tax results of associates and joint ventures, included at the pre-tax profit level under IFRS, was £1,236 million in 2015, compared to £719 million in 2014. This increase of £517 million, or 71.9%, was principally driven by an adjusting item resulting from RAI's gain on divestiture in 2015, of which BAT's share was £371 million (net of tax). For more information on adjusting items in the results of associates and joint ventures, see note 5(a) to the BAT Group's consolidated financial statements included in this Offering Memorandum.

Taxation on Ordinary Activities

Taxation on ordinary activities was £1,333 million in 2015, compared to £1,455 million in 2014. The BAT Group's effective tax rates were 22.8% in 2015 and 30.0% in 2014, which were affected by the inclusion of the

share of associates' post-tax profit in the BAT Group's pre-tax results and by adjusting items, notably the deemed gain related to the investment in RAI of £601 million in 2015 discussed above. Excluding these, the underlying tax rate for subsidiaries was 30.5% and 30.6% in 2015 and 2014, respectively. The slight decrease in 2015 is the result of a change in the mix of profits. The BAT Group's share of post-tax results of associates and joint ventures was £1,236 million in 2015 and £719 million in 2014. Adjusting items in taxation totaled £22 million in 2015 (£nil in 2014), resulting from additional deferred tax charge on potential distributions of undistributed earnings from the BAT Group's share of the gain on divestiture by RAI. For more information on adjusting items in taxation, see note 6(d) to the BAT Group's consolidated financial statements included in this Offering Memorandum.

Profit for the Year

As a result of the above, profit for the year increased by £1,129 million, or 33.3%, from £3,393 million for 2014 to £4,522 million for 2015.

Adjusting Items in Profit from Operations

In 2015, adjusting items in profit from operations decreased by £422 million from £857 million in 2014 to £435 million in 2015, or 49.2%. This decrease was driven primarily by a £371 million decrease in Flintkote charges, due to a BAT Group subsidiary entering into a settlement agreement in connection with various legal cases related to a former non-tobacco business in Canada.

The decrease in adjusting items in profit from operations was also driven by restructuring and integration costs, which decreased by £85 million in 2015 to £367 million, down from £452 million in 2014. In addition to costs related to implementation of a new operating model and the cost of initiatives in respect of permanent headcount reductions and permanent employee benefit reductions in both 2015 and 2014, restructuring and integration costs in 2015 included factory closure and downsizing activities in Australia, certain costs related to the acquisitions undertaken (including TDR in Croatia) and restructurings in Indonesia, Canada, Switzerland and Germany. In 2014, restructuring and integration costs also included factory closure and downsizing activities in Australia, Colombia and the Democratic Republic of Congo, and restructurings in Argentina, Indonesia, Canada, Switzerland and Germany.

Results of Operations by Geographic Region

The BAT Group, excluding the BAT Group's associated undertakings, is currently organized into four geographic regions: Asia-Pacific, Americas, Western Europe and EEMEA. The four geographic regions are the reportable segments for the BAT Group as they form the focus of the BAT Group's internal reporting systems and are the basis used by the BAT Group management board, which functions collectively as the chief operating decision maker for assessing performance and allocating resources. The BAT Group management board reviews, among other data, segmental revenue, segmental profit from operations, segmental adjusted profit from operations, and segmental revenue and segmental adjusted profit from operations at constant rates of exchange based on a retranslation, at prior year exchange rates, of the current year results of the BAT Group. Refer to note 2 to the BAT Group's consolidated financial statements included in this Offering Memorandum for further discussion of the segmental results and for the reconciliation of segmental revenue at constant rates of exchange to segmental revenue, and of adjusted profit from operations at current and constant rates of exchange to segmental profit from operations and to group profit for the year.

The following tables set forth a breakdown of the volume, revenue, profit from operations, adjusted profit from operations and movements at constant rates of exchange by geographic region for 2016, 2015 and 2014 and the six months ended June 30, 2017 and 2016.

	Volume[1]		**Revenue**[2]		**Increase/(decrease) in revenue at constant rates of exchange**[2][3]
	Six months ended June 30,		**Six months ended June 30,**		**Six months ended June 30,**
	2017	**2016**	**2017**	**2016**	**2017**
	(billions)		**(£ millions)**		**(£ millions)**
Asia-Pacific	95	105	2,191	1,987	(58)
Americas	53	56	1,545	1,297	84
Western Europe	58	57	2,030	1,729	108
EEMEA	108	114	1,951	1,656	98
Total	**314**	**332**	**7,717**	**6,669**	**232**

	Volume[1]			Revenue[2]			Increase/(decrease) in revenue at constant rates of exchange[2][3]	
	2016	2015	2014	2016	2015	2014	2016	2015
	(billions)			(£ millions)			(£ millions)	
Asia-Pacific	196	198	197	4,266	3,773	3,873	(3)	1
Americas	113	124	131	2,868	2,720	2,990	294	350
Western Europe	120	112	112	3,867	3,203	3,359	268	117
EEMEA	236	229	227	3,750	3,408	3,749	345	281
Total	**665**	**663**	**667**	**14,751**	**13,104**	**13,971**	**904**	**749**

Notes:

(1) Data relating to volume by region for 2016, 2015, and 2014 and the six months ended June 30, 2017 and 2016 is unaudited and has been extracted from the BAT Group's marketing records.

(2) The above historical segmental financial data has been extracted from note 2, Segmental Analyses, to the BAT Group's consolidated financial statements and from note 2, Analysis of Volume, Revenue, Profit from Operations and Diluted Earnings per Share by Segment, to the BAT Group's unaudited condensed consolidated financial statements included in this Offering Memorandum. The historical financial data for the six months ended June 30, 2017 and 2016 is unaudited. See further discussion at "*Presentation of Financial Information and Other Data*".

(3) Revenue at constant rates of exchange is a non-IFRS measure. Revenue at constant rates of exchange for 2016 is based on a retranslation at 2015 exchange rates of the 2016 results of BAT. Revenue at constant rates of exchange for 2015 is based on a retranslation at 2014 exchange rates of the 2015 results of BAT. Revenue at constant rates of exchange for June 30, 2017 is based on a retranslation at exchange rates for the six months ended June 30, 2016 of the results of BAT for the six months ended June 30, 2017.

	Profit from operations[1]		Adjusted profit from operations[1][2]		Increase/(decrease) in adjusted profit from operations at constant rates of exchange[1][2][3]
	Six Months ended June 30,		Six Months ended June 30,		Six Months ended June 30, 2017
	2017	2016	2017	2016	
			(£ millions)		
Asia-Pacific	828	700	871	761	18
Americas	570	484	616	536	13
Western Europe	543	516	689	590	29
EEMEA	633	533	665	565	19
Total	**2,574**	**2,233**	**2,841**	**2,452**	**79**

	Profit from operations[1]			Adjusted profit from operations[1][2]			Increase/(decrease) in adjusted profit from operations at constant rates of exchange[1][2][3]	
	2016	2015	2014	2016	2015	2014	2016	2015
	(£ millions)			(£ millions)			(£ millions)	
Asia-Pacific	1,432	1,361	1,360	1,630	1,469	1,548	19	(2)
Americas	1,017	1,082	1,197	1,172	1,169	1,286	33	140
Western Europe	1,044	990	1,018	1,389	1,146	1,189	90	60
EEMEA	1,182	1,127	1,318	1,289	1,208	1,380	63	19
Total	**4,675**	**4,560**	**4,893**	**5,480**	**4,992**	**5,403**	**205**	**217**

Notes:

(1) The above historical segmental financial data has been extracted from note 2 to the BAT Group's consolidated financial statements and from note 2, Analysis of Volume, Revenue, Profit from Operations and Diluted Earnings per Share by Segment, to the BAT Group's unaudited condensed consolidated financial statements included in this Offering Memorandum. The historical financial data for the six months ended June 30, 2017 and 2016 is unaudited. See "*Presentation of Financial Information and Other Data*".

(2) Adjusted profit from operations is a non-IFRS measure. See "*Summary Historical Consolidated Financial Data of BAT*" for additional information about adjusted profit from operations, as well as a reconciliation to profit from operations.

(3) Adjusted profit from operations at constant rates of exchange is a non-IFRS measure. Adjusted profit from operations at constant rates of exchange for 2016 is based on a retranslation at 2015 exchange rates of the 2016 results of the BAT Group. Adjusted profit from operations at constant rates of exchange for 2015 is based on a retranslation at 2014 exchange rates of the 2015 results of the BAT Group. Adjusted profit from operations at constant rates of exchange for June 30, 2017 is based on a retranslation at exchange rates for the six months ended June 30, 2016 of the results of BAT for the six months ended June 30, 2017.

The Six Months Ended June 30, 2017 Compared with the Six Months Ended June 30, 2016

Asia-Pacific

Profit from operations increased by £128 million, or 18.3%, due to the weakness of the pound sterling against the main operating currencies in the region, most notably the Australian dollar. Adjusted profit from operations increased by £110 million or 14.4%. Adjusted profit from operations at constant rates of exchange increased by £18 million, or 2.3%, as profit growth in Australia, Bangladesh, Vietnam and New Zealand was partially offset by the impact of the excise-led price increase in Malaysia and Pakistan leading to down-trading and higher illicit trade. Volume was down 9.8% at 95 billion, as increases in Bangladesh and Vietnam were more than offset by lower volume driven by market contraction in Pakistan, Malaysia, Indonesia and the growth of the THP category in Japan. Excluding the impact of Pakistan, volume was 0.5% up versus the prior-year period.

Results in Asia-Pacific were impacted by the following developments:

- Australia — Adjusted profit from operations at constant rates of exchange grew, driven by improved pricing more than offsetting marginally lower volume. Market share was higher, driven by Rothmans and Winfield, particularly capsules.
- Japan — Market share continued to grow, driven by Kent. Adjusted profit from operations at constant rates of exchange was down against the prior-year period as cost savings did not offset the impact of lower volumes and the investment behind THP. In Sendai, glo continued to grow (reaching 8% retail market share in a leading convenience store chain) and distribution was extended across Miyagi and to Osaka and Tokyo, where it registered 2% market share (in a leading convenience store chain) within two weeks of launch.
- Pakistan — Volume was lower driven by the unwinding of stock movements ahead of the 2016 excise-led price rise, a contraction in the market size and a significant increase in illicit trade. Adjusted profit from operations at constant rates of exchange declined, driven by the fall in volume and down-trading. Market share was lower as the effect of low priced competition was partly offset by an increase in Pall Mall and JPGL which outperformed the market.
- Malaysia — Volume declined as the excise-led price increase in 2015 continues to impact consumer affordability, driving an increase in illicit trade, and a decrease in adjusted profit from operations at constant rates of exchange. Market share fell as Dunhill was impacted by down-trading, but has largely stabilized in the last quarter.
- Bangladesh — Higher adjusted profit from operations at constant rates of exchange was driven by pricing and volume growth. Market share continued to increase.
- New Zealand — Adjusted profit from operations at constant rates of exchange grew, led by pricing, with volume flat. Market share was up, as Rothmans and Club offset a decline in Pall Mall.
- Vietnam — An increase in volume, improved mix and pricing led to higher adjusted profit from operations at constant rates of exchange. Market share fell as growth in State Express 555 was offset by declines in local brands.
- South Korea — Adjusted profit from operations at constant rates of exchange was higher as cost savings offset lower volume. The volume decline was in part due to market contraction, with market share down.
- Philippines — Pricing led to an improvement in adjusted profit from operations at constant rates of exchange. Market share was marginally lower as volume declined.
- Indonesia — Volume decreased with market share lower, as the impact of the excise-led price increase resulted in down-trading and industry contraction. Lucky Strike continued to grow. Cost savings drove an improvement in adjusted profit from operations at constant rates of exchange.

Americas

Profit from operations increased by £86 million, or 17.8%, partly driven by the weakness in the pound sterling against the key operating currencies, notably the Brazilian real and Canadian dollar. Adjusted profit from operations increased by £80 million or 14.8%. Adjusted profit from operations at constant rates of exchange grew by £13 million, or 2.3%, as good performances in Canada, Chile, Mexico and Colombia were partially offset by lower profit in Brazil. Volume was 53 billion, a decline of 6.5%, as lower volume in Brazil, Venezuela, Canada and Argentina was only partially offset by higher volume in Mexico.

Results in the Americas were impacted by the following developments:

- Canada — Pricing led to an increase in adjusted profit from operations at constant rates of exchange, despite lower volume. Market share was stable, with Pall Mall the fastest growing brand in the market. During the period, glo was launched in Vancouver.
- Brazil — Growth in Minister, combined with the migration of Free to Kent, was more than offset by the remainder of the portfolio, with total market share lower. Continued weakness in consumer disposable income and the excise increases led to down-trading and further growth in illicit trade, negatively impacting volume and adjusted profit from operations at constant rates of exchange.
- Chile — Market share grew, driven by Kent, Lucky Strike and Pall Mall. Adjusted profit from operations at constant rates of exchange increased, driven by pricing, offsetting the impact of lower volume due to market contraction.
- Mexico — Pricing, cost savings and higher volume, driven by Pall Mall, led to an increase in adjusted profit from operations at constant rates of exchange.
- Venezuela — Pricing to offset currency devaluation and inflation led to higher adjusted profit from operations at constant rates of exchange. Volume fell, due to above inflation price increases and the challenging economic environment which impacted consumer disposable income.
- Argentina — Market share was higher, driven by growth in Viceroy and Rothmans. Volume fell, following the excise increase which led to a decline in the total market size. Adjusted profitability at constant rates of exchange was stable.
- Colombia — Market share continued to increase due to the growth in Lucky Strike. Pricing and mix more than offset a decline in volume, with adjusted profit from operations at constant rates of exchange up.

Western Europe

Profit from operations increased by £27 million, or 5.2%, partly driven by the weakness in the pound sterling. Adjusted profit from operations increased by £99 million or 16.8%. Adjusted profit from operations at constant rates of exchange increased by £29 million, or 4.8%, as good performances in Romania, Germany and Denmark were partially offset by weaker performance in France and the United Kingdom. Volume was 0.7% ahead of prior year at 58 billion. Excluding the brands acquired from Bulgartabac in the period, on an organic basis, volume was down 0.4% as growth in Spain, Poland and Romania was more than offset by reductions in Italy, Germany and France. Fine Cut volume grew 0.4%, mainly due to growth in the Make-Your-Own category in Poland, Germany and Czech Republic.

Results in Western Europe were impacted by the following developments:

- Germany — Adjusted profit from operations at constant rates of exchange was higher as pricing and the impact of a local restructuring offset lower volume. Market share grew, driven by Pall Mall. Fine Cut volume was up. Vype retail market share was 8%.
- Romania — Adjusted profit from operations at constant rates of exchange grew driven by an improved mix, pricing, cost savings and higher volume, which grew faster than the total market due to the performance of Pall Mall and Dunhill.
- Switzerland — Adjusted profit from operations at constant rates of exchange was higher as the phasing of marketing activities offset lower volume. Market share fell due to the impact of discounting in the market. glo was launched within a key account with national presence.
- France — Market share fell, with adjusted profit from operations at constant rates of exchange lower following the partial absorption of excise. Volume was down. Vype retail market share grew to 7%.
- Denmark — Adjusted profit from operations at constant rates of exchange was up on stable volume, with market share marginally lower despite continued growth of Pall Mall.
- Italy — Rothmans continued to grow, driving total market share higher. Adjusted profit from operations at constant rates of exchange was in line with prior year as pricing and the timing of marketing activities, offset a decline in total volume. Vype increased retail market share to over 11%.
- Belgium — Adjusted profit from operations at constant rates of exchange and volume were lower, with total market share down.

- Netherlands — Adjusted profit from operations at constant rates of exchange fell, driven by a reduction in volume and market share.
- United Kingdom — Volume and adjusted profit from operations at constant rates were lower due to the competitive pricing environment. Market share was marginally higher. Total retail market share of the NGP grew to over 41%, with Vype increasing to approximately 11% as both Pebble and e-Pen performed well.
- Spain — Volume and adjusted profit from operations at constant rates of exchange were higher than prior year, with an increase in market share driven by Lucky Strike and Rothmans.
- Poland — Volume was up with adjusted profit from operations at constant rates of exchange marginally ahead of prior year. Market share was higher driven by Pall Mall. Vype grew, exceeding 6% retail market share.
- Croatia — Adjusted profit from operations at constant rates of exchange was up, with volume down. Market share increased driven by the GDB portfolio.

EEMEA

Profit from operations increased by £100 million, or 18.8%, partly due to the weakness of the pound sterling. Adjusted profit from operations increased by £100 million, or 17.7%. Adjusted profit from operations at constant rates of exchange grew by £19 million, or 3.5%, as good performances in Turkey, Iran, Ukraine and North Africa more than offset lower profit in South Africa and Russia. Volume was 4.6% lower at 108 billion as growth in GCC, Nigeria and North Africa was more than offset by lower volume in Ukraine, Russia and South Africa.

Results in EEMEA were impacted by the following developments:

- Russia — Adjusted profit from operations at constant rates of exchange declined driven by competitor-led price discounting in the market and down-trading. Volume fell due to market contraction and higher illicit trade. Rothmans and Royals performed well, leading to an increase in market share.
- South Africa — Volume and adjusted profit from operations at constant rates of exchange fell due to down-trading and the growth in illicit trade. Benson & Hedges and Dunhill continued to grow market share although this was more than offset by Peter Stuyvesant, with total market share down.
- GCC — Volume was up, with adjusted profit from operations at constant rates of exchange lower driven by down-trading.
- Nigeria — Volume grew, driven by Rothmans. Adjusted profit from operations at constant rates of exchange was lower largely due to the impact of transactional foreign exchange on our cost base, which was not offset by pricing.
- Turkey — Higher adjusted profit from operations at constant rates of exchange was driven by pricing, more than offsetting a decline in volume. Market share was up as the growth momentum of Kent and Rothmans continued.
- Iran — Adjusted profit from operations at constant rates of exchange grew and volume declined due to the effect of the excise change in 2016.
- Kazakhstan — Adjusted profit from operations at constant rates of exchange and volume declined against prior year.
- Ukraine — The financial performance improved, as prices recovered from a challenging period. Volume was down partly due to short term disruption to industry distribution.
- Algeria — Volume and adjusted profit from operations at constant rates of exchange were up, driven by Rothmans and pricing.

2016 Compared with 2015

Asia-Pacific

In Asia-Pacific, profit from operations increased by £71 million to £1,432 million in 2016. In addition to the impact of adjusting items and foreign exchange movements, profit from operations was impacted by improved underlying business performances in Pakistan, Bangladesh, Sri Lanka, Vietnam and South Korea, which were partially offset by declining underlying business performance in Malaysia following a change in excise and the adverse impact of foreign exchange on raw materials and consumables used in a number of markets including

Japan and New Zealand. Adjusted profit from operations increased by £161 million to £1,630 million in 2016, which excludes the impact of adjusting items in profit from operations of £198 million (2015: £108 million), resulting from South Korea sales tax, restructurings in Japan and Australia, downsizing in Malaysia and amortization of trademarks and similar intangibles. At constant rates of exchange, adjusted profit from operations in 2016 would have increased by £19 million, or 1.3%, to £1,488 million, up from adjusted profit from operations of £1,469 million in 2015. Volume at 196 billion was down by 0.9% from 2015, as volume increases in Bangladesh, Vietnam, South Korea and Indonesia were offset by volume declines in Pakistan and Malaysia.

Results in Asia-Pacific were impacted by the following developments:

- Australia — market share returned to growth, driven by Rothmans. Pricing in the second half of the year was offset by lower volume due to the market contraction and down-trading, leading to a reduction in adjusted profit from operations at constant rates of exchange.
- Malaysia — volume and adjusted profit from operations at constant rates of exchange were down as tax-driven price increases led to a reduction in the total market and higher illicit trade. Market share fell despite growth in Peter Stuyvesant as Dunhill was impacted by down-trading.
- Japan — market share of combustibles grew, driven by Kent. Lower volume and adverse foreign exchange movements affecting raw materials and consumables used led to a reduction in adjusted profit from operations at constant rates of exchange.
- New Zealand — pricing, an increase in market share and stable volume were more than offset by the adverse impact of foreign exchange on raw materials and consumables used, with adjusted profit from operations at constant rates of exchange marginally lower.
- Bangladesh — volume, market share and adjusted profit from operations at constant rates of exchange continued to increase.
- Pakistan — adjusted profit from operations at constant rates of exchange increased as a result of pricing and cost savings. Market share grew, driven by Pall Mall. Market contraction led to lower volume as illicit trade increased significantly following excise-led price increases.
- Vietnam — higher adjusted profit from operations at constant rates of exchange was driven by an increase in volume, pricing and favorable product mix. Market share was stable as State Express 555 continued to perform well in the premium segment.
- South Korea — adjusted profit from operations at constant rates of exchange was up, driven by higher volume, including in Dunhill, and productivity initiatives. Market share fell despite growth in Rothmans.
- Indonesia — volume and market share grew, driven by Dunhill and Lucky Strike, with the favorable product mix and pricing leading to an improvement in adjusted profit from operations at constant rates of exchange.
- Philippines — market share was marginally higher, driven by Pall Mall. Pricing and productivity initiatives more than offset a decline in volume, leading to an improvement in adjusted profit from operations at constant rates of exchange.

Americas

In the Americas, profit from operations decreased by £65 million to £1,017 million in 2016. In addition to the impact of adjusting items and foreign exchange movements, particularly the devaluation of the bolivar in Venezuela, profit from operations was impacted by improved underlying business performances in Canada, Chile and Peru, which was more than offset by declining underlying business performance in Brazil. Adjusted profit from operations was marginally ahead of the prior year at £1,172 million, which excludes the impact of adjusting items in profit from operations of £155 million (2015: £87 million), including the downsizing in Brazil and the amortization and impairment of trademarks and similar intangibles. At constant rates, adjusted profit from operations would have increased by £33 million, or 2.8%, to £1,202 million in 2016, up from adjusted profit from operations of £1,169 million in 2015. Volume in 2016 in the Americas was down by 8.8% at 113 billion, as higher volume in Mexico and Colombia was more than offset by declines in Brazil and Venezuela.

Results in the Americas were impacted by the following developments:

- Brazil — Lucky Strike grew market share, with Dunhill growing within the premium segment, although total market share declined. Lower consumer disposable income, higher VAT and excise-led price increases drove market contraction and higher illicit trade, adversely impacting volume and adjusted profit from operations at constant rates of exchange.

- Canada — growth in adjusted profit from operations at constant rates of exchange was driven by pricing and cost reductions, which offset lower volume. Market share fell, despite growth in Pall Mall.
- Chile — pricing and an improvement in mix led to higher adjusted profit from operations at constant rates of exchange. Total volume fell but market share was up, driven by Kent following the successful migration from Belmont.
- Venezuela — pricing, to offset currency devaluation and inflation, led to higher adjusted profit from operations at constant rates of exchange. Pall Mall volume grew although, due to the reduction in consumer disposable income, total volume fell.
- Mexico — volume was up, driven by the continued growth in Pall Mall. A delay in pricing increases in line with costs led to stable adjusted profit from operations at constant rates of exchange.
- Colombia — higher volume, an improvement in market share and pricing were more than offset by the adverse impact of foreign exchange on raw materials and consumables used, with adjusted profit from operations at constant rates of exchange down.
- Argentina — excise-led price increases drove a decrease in the total market and a decline in volume. Market share was marginally lower despite Rothmans growth following launch in 2016.

Western Europe

In Western Europe, profit from operations increased by £54 million to £1,044 million in 2016. In addition to the impact of adjusting items and foreign exchange movements, particularly the relative weakness in the pound sterling against the euro, profit from operations was impacted by improved underlying business performances in several markets including Germany, Romania, Italy and France. Adjusted profit from operations increased by £243 million to £1,389 million, which excludes adjusting items in profit from operations of £345 million (2015: £156 million), including costs of factory closure and downsizing in Germany and amortization of trademarks and similar intangibles in 2016. At constant rates of exchange, adjusted profit from operations would have increased by £90 million, or 7.8%, to £1,236 million in 2016, compared to adjusted profit from operations of £1,146 million in 2015, reflecting the strength of the euro in 2016. Volume was up by 6.7% to 120 billion in 2016, with growth in Poland and Romania more than offsetting lower volume in the United Kingdom, Denmark and Germany.

Results in Western Europe were impacted by the following developments:

- Germany — adjusted profit from operations at constant rates of exchange grew primarily resulting from pricing, with volume marginally lower. Market share was flat as growth by Lucky Strike was offset by declines in the local brands. Fine Cut volume and market share fell due to increased price competition. Vype was launched nationally, growing to 7% category retail market share.
- Switzerland — price discounting by competitors at retail led to lower volume, a fall in market share and a decline in adjusted profit from operations at constant rates of exchange.
- France — adjusted profit from operations at constant rates of exchange and volume were marginally higher. Market share was up, driven by the continued growth in Lucky Strike.
- Romania — adjusted profit from operations at constant rates of exchange increased, driven by pricing and higher volume. Pall Mall and Dunhill increased market share, more than offsetting a decline in Kent.
- Italy — higher volume and pricing drove an increase in adjusted profit from operations at constant rates of exchange. Growth in Rothmans market share was more than offset by declines in the rest of the local portfolio with total market share down. Vype distribution was expanded. Pebble was launched and the first flagship store was opened.
- Denmark — volume, market share and adjusted profit from operations at constant rates of exchange were down due to down-trading leading to the growth of the low-priced segment.
- Netherlands — adjusted profit from operations at constant rates of exchange grew, driven by a lower cost base. Market share growth in Pall Mall and Lucky Strike was more than offset by a decline in Kent and local brands, reducing total market share.
- Belgium — adjusted profit from operations at constant rates of exchange fell, driven by lower volume. Market share fell as the decline in Kent more than offset the continued growth in Lucky Strike.

- United Kingdom — a challenging pricing environment led to a decline in market share, with adjusted profit from operations at constant rates of exchange stable as cost reductions offset lower volume. Total retail market share of the next generation products business grew to nearly 40% driven by the continued growth of Vype and the acquisition of Ten Motives.
- Spain — adjusted profit from operations at constant rates of exchange was marginally higher, driven by cost savings. Volume and market share were stable.
- Poland — market share grew with volume higher due to the success of Pall Mall. Adjusted profit from operations at constant rates of exchange improved driven by the improved volume and pricing.
- Croatia/Balkans — the integration of TDR is now substantially complete, with the migration to the global drive brands portfolio on track, driving an increase in total market share.

EEMEA

In EEMEA, profit from operations increased by £55 million to £1,182 million in 2016. In addition to the impact of adjusting items and foreign exchange movements, particularly currency devaluation in Russia, Nigeria and Ukraine, profit from operations for the year was positively impacted by pricing across the region and improved underlying business performance in several markets. Adjusted profit from operations increased by £81 million to £1,289 million, which excludes the impact of adjusting items in profit from operations of £107 million (2015: £81 million), including amortization of trademark and similar intangibles and restructuring costs in South Africa. At constant rates of exchange, adjusted profit from operations would have increased by £63 million, or 5.3%, to £1,271 million in 2016, up from adjusted profit from operations of £1,208 million in 2015. EEMEA volume at 236 billion in 2016 was 3.0% higher than 2015, as growth in a number of markets including Ukraine, Russia, Turkey and Algeria were partially offset by lower volume in South Africa and the Gulf Cooperation Council.

Results in EEMEA were impacted by the following developments:

- Russia — adjusted profit from operations at constant rates of exchange increased, driven by pricing and an increase in volume more than offsetting the continuing adverse impact of foreign exchange on raw materials and consumables used. Market share continued to grow, driven by improved market share by Rothmans with Kent premium segment share increasing.
- South Africa — volume fell, driven by down-trading to the low-priced segment and higher illicit trade. Dunhill, Pall Mall and Benson & Hedges all grew market share although total market share fell. Adjusted profit from operations at constant rates of exchange was down due to lower volume and the adverse transactional impact of foreign exchange on raw materials and consumables used, partially offset by pricing.
- Gulf Cooperation Council — adjusted profit from operations at constant rates of exchange was flat as pricing and cost savings were offset by lower volume. Market share fell as Dunhill was impacted by down-trading following tax driven price increases.
- Nigeria — volume growth and pricing were offset by the adverse impact of foreign exchange on raw materials and consumables used, with adjusted profit from operations at constant rates of exchange in line with prior year.
- Iran — volume and adjusted profit from operations at constant rates of exchange were lower due to the retrospective application of an increase in excise.
- Ukraine — volume and market share growth was driven by Rothmans. Geopolitical instability continued to impact the financial performance, with a significant deterioration in currency and intense price competition leading to a decline in adjusted profit from operations at constant rates of exchange.
- Turkey — adjusted profit from operations at constant rates of exchange was up, driven by pricing and higher volume. Market share grew, driven by Kent and Rothmans.
- Egypt — an improvement in adjusted profit from operations at constant rates of exchange was driven by higher volume, pricing and an enhanced mix.
- Kazakhstan — Rothmans drove an increase in volume and market share. Adjusted profit from operations at constant rates of exchange improved as pricing and higher volume more than offset the effect of down-trading.
- Algeria — volume growth and pricing drove an increase in adjusted profit from operations at constant rates of exchange.

2015 Compared with 2014

Asia-Pacific

In Asia-Pacific, profit from operations was £1,361 million in 2015, slightly up from £1,360 million in 2014. In addition to the impact of adjusting items and foreign exchange movements, including adverse foreign exchange rates in a number of markets, profit from operations was impacted by improved underlying business performances in Pakistan, Bangladesh, New Zealand, Sri Lanka and Vietnam and a challenging environment in Australia. Adjusted profit from operations decreased by £79 million to £1,469 million, due to a decrease in the impact of adjusting items in profit from operations, which totaled £108 million (2014: £188 million), including restructuring costs in Australia, which decreased from 2014, and downsizing in Malaysia. At constant rates of exchange, adjusted profit from operations in 2015 was consistent with the prior year at £1,546 million in 2015, compared to adjusted profit from operations of £1,548 million in 2014. Volume in 2015 was marginally ahead of 2014 at 198 billion, as increases in Bangladesh, Vietnam, Indonesia and Japan were offset by Pakistan, Malaysia and South Korea, where lower volume was due to market decline.

Results in Asia-Pacific were impacted by the following developments:

- Australia — volume fell due to market contraction. Excise-led price increases, a challenging environment and continued high prevalence of illicit trade led to down-trading and a significant reduction in adjusted profit from operations at constant rates of exchange. Market share was flat.
- New Zealand — adjusted profit from operations at constant rates of exchange was higher as pricing offset lower volume. Increases in Rothmans led to an increase in market share.
- Malaysia — adjusted profit from operations at constant rates of exchange was stable, as the introduction of excise–led price increases were offset by a reduction in volume, which was partly due to an increase in illicit trade. Market share was up, driven by Peter Stuyvesant.
- Japan — growth in market share was driven by Kent, supported by innovations. Adjusted profit from operations at constant rates of exchange was down mainly due to the adverse exchange rate impact on raw materials and consumables used, which was partly mitigated by productivity savings.
- Vietnam — volume was up, in line with the industry. Adjusted profit from operations at constant rates of exchange was higher due to increased volume, pricing and an improvement in mix.
- South Korea — market share grew, driven by Dunhill and Vogue. Volume declined as a result of significant industry contraction following high excise-driven price increases, leading to lower adjusted profit from operations at constant rates of exchange.
- Philippines — market share increased driven by Pall Mall, leading to an improvement in adjusted profit from operations at constant rates of exchange.
- Pakistan — high excise-driven pricing led to market contraction and an increase in illicit trade. Volume decline was lower than the market, leading to an increase in market share, particularly in Pall Mall. The full-year effect of pricing taken in 2014 and cost efficiencies drove adjusted profit from operations at constant rates of exchange higher.
- Bangladesh — adjusted profit from operations at constant rates of exchange continued to increase, driven by higher volume, significant market share growth and higher pricing.
- Indonesia — volume and market share were up and adjusted profit from operations improved as Dunhill continued to grow, driving an improvement in mix and offsetting the decline in local brands.
- Taiwan — market share was higher driven by Pall Mall. Pricing was offset by marketing investment, leading to a small decline in profit from operations.

Americas

In the Americas, profit from operations declined by £115 million to £1,082 million in 2015. In addition to the impact of adjusting items and foreign exchange movements, particularly adverse movements in Brazil, Canada and Venezuela, profit from operations was impacted by improved underlying business performances in Canada, Mexico, Venezuela and Chile. Adjusting items in profit from operations, which totaled £87 million (2014: £89 million), included restructurings in Canada. Adjusted profit from operations declined by £117 million to £1,169 million in 2015, in line with the decrease in profit from operations. At constant rates of exchange, adjusted profit from operations would have increased by £140 million, or 10.9%, to £1,426 million in 2015 compared to adjusted profit from operations of £1,286 million in 2014, as adjusted profit from operations at constant rates of exchange in 2015 excludes the impact of adverse foreign exchange rate movements. Volume was lower by 5.2% at 124 billion, mainly due to Brazil, Argentina, Chile and Canada, partially offset by higher volume in Mexico.

Results in the Americas were impacted by the following developments:

- Brazil — Dunhill and MINISTER performed well with higher market share, but were more than offset by the rest of the portfolio. Market contraction due to the effects of illicit trade and the deterioration in the economic environment led to lower volume and a reduction in adjusted profit from operations at constant rates of exchange.
- Canada — adjusted profit from operations at constant rates of exchange grew driven by pricing and cost reductions, offsetting lower volume. Market share fell, despite growth in Pall Mall.
- Mexico — market share was up, driven by the continued growth in Pall Mall and Lucky Strike. Adjusted profit from operations at constant rates of exchange was higher driven by pricing and higher volume.
- Argentina — pricing more than offset the impact of lower volume and led to higher adjusted profit from operations at constant rates of exchange. Lucky Strike grew market share, continuing to perform well in the premium segment.
- Chile — growth in adjusted profit from operations at constant rates of exchange was due to pricing and up-trading to capsule offers, offsetting lower volume and the effect of adverse exchange rates on raw materials and consumables used. Kent, Lucky Strike and Pall Mall all grew market share.
- Venezuela — adjusted profit from operations at constant rates of exchange was higher, as pricing changes were required to offset the combined effects of local inflation and the devaluation of the bolivar following the introduction of the SIMADI exchange rate mechanism. Volume was marginally lower.
- Colombia — market share growth was partly driven by Kool and Lucky Strike, with volume flat despite industry decline. Adjusted profit from operations at constant rates of exchange was up as pricing offset the impact of adverse foreign exchange on raw materials and consumables used.

Western Europe

In Western Europe, profit from operations decreased by £28 million to £990 million in 2015. In addition to the impact of adjusting items and foreign exchange movements, particularly the devaluation of the euro, profit from operations was impacted by the effect of lower volume in Italy and The Netherlands, partially offset by improved underlying business performances in a number of markets, including Denmark, Germany and Romania. Adjusting items in profit from operations, which totaled £156 million (2014: £171 million), included certain costs related to the acquisition of TDR and restructurings in Switzerland and Germany. Adjusted profit from operations declined by £43 million to £1,146 million due to the decrease in profit from operations and a decrease in adjusting items in profit from operations. At constant exchange rates, adjusted profit from operations would have increased by £60 million, or 5.1%, to £1,249 million in 2015 compared to adjusted profit from operations of £1,189 million in 2014. Total volume was up by 0.5% at 112 billion, but, excluding the acquisition of TDR, would have declined by 1.1%. Fine Cut volume was lower by 3.9% at 20 billion sticks equivalent.

Results in Western Europe were impacted by the following developments:

- Italy — the migration of Pall Mall to Rothmans progressed well, with an increase in the brands' combined market share. Total volume fell, with adjusted profit from operations at constant rates of exchange down partly due to increased marketing investment.
- Germany — volume and market share were higher, driven by Lucky Strike and Pall Mall, which, coupled with pricing, led to an increase in adjusted profit from operations at constant rates of exchange. Fine Cut volume was lower.
- France — volume was higher as Lucky Strike continued to perform well, driving an increase in total market share. Adjusted profit from operations at constant rates of exchange fell, partly due to down-trading and increased marketing investment.
- Spain — adjusted profit from operations at constant rates of exchange was stable as pricing was offset by lower volume and reduction in market share.
- Switzerland — adjusted profit from operations at constant rates of exchange was up as pricing offset lower volume and a decline in market share.
- Belgium — adjusted profit from operations at constant rates of exchange was stable, as pricing offset lower volume. Market share declined as growth in Lucky Strike was more than offset by the rest of the local portfolio.

- Netherlands — Lucky Strike and Pall Mall market share improved. Industry decline led to lower volume and a reduction in adjusted profit from operations at constant rates of exchange.
- Poland — adjusted profit from operations at constant rates of exchange improved, as pricing more than offset a fall in volume, which was in part due to further industry contraction. Pall Mall continued to demonstrate momentum with an increase in market share.
- Denmark — volume and adjusted profit from operations at constant rates of exchange were higher following the trade de-stocking in 2014. Market share declined driven by competitive pricing activity at the low end of the market.
- Romania — market share grew, driven by Pall Mall and Dunhill, consolidating the BAT Group's leadership position. Pricing and a marginal increase in volume drove adjusted profit from operations at constant rates of exchange higher.
- United Kingdom — Rothmans drove an increase in market share, with adjusted profit from operations at constant rates of exchange higher as pricing offset marginally lower volume, due to industry decline.

EEMEA

In EEMEA, profit from operations decreased by £191 million to £1,127 million in 2015. In addition to the impact of adjusting items, profit from operations was positively impacted by pricing across the region and improved underlying business performances in a number of markets, which was more than offset by the impact of foreign exchange movements, particularly the effect of currency devaluation in Russia, Nigeria and Ukraine. Adjusting items in profit from operations, totaling £81 million (2014: £62 million), included amortization of trademarks and similar intangibles. Adjusted profit from operations in EEMEA decreased by £172 million to £1,208 million in 2015, principally as a result of the decrease in profit from operations. At constant rates of exchange, adjusted profit from operations would have increased by £19 million, or 1.3%, to £1,399 million in 2015 compared to adjusted profit from operations of £1,380 million in 2014. Volume was 1.1% higher at 229 billion, with growth in a number of markets including Turkey, Iran, Kazakhstan and Ukraine offsetting lower volume in Egypt, Russia, Nigeria and South Africa.

Results in EEMEA were impacted by the following developments:

- Russia — market share continued to grow, driven by increased performance from Rothmans. Industry volume decline was due to excise-led price increases, with the BAT Group's volume falling at a lower rate than the market. Pricing partially offset the significant adverse effect of devaluation on raw materials and consumables used, leading to a decrease in adjusted profit from operations at constant rates of exchange.
- Ukraine — geopolitical instability continued to impact performance, with a significant deterioration in currency and intense price competition leading to a decline in adjusted profit from operations at constant rates of exchange. Volume was up, driven by Rothmans, and market share grew.
- Turkey — higher volume and market share growth were driven by Kent and Rothmans. Adjusted profit from operations at constant rates of exchange fell due to the continued part absorption of excise.
- Gulf Cooperation Council — higher volume, driven by JPGL and Rothmans, and the full-year effect of pricing taken in 2014 more than offset negative mix to deliver an increase in adjusted profit from operations at constant rates of exchange. Total market share declined.
- Egypt — volume, market share and adjusted profit from operations at constant rates of exchange declined, due to down-trading following the change in the excise regime in 2014.
- Nigeria — adjusted profit from operations at constant rates of exchange was down, partly due to the effect of adverse exchange rates on raw materials and consumables used and a reduction in volume, which was driven by market contraction. Market share was up.
- South Africa — market share was down despite good growth from Benson & Hedges, following the launch in 2014, and Pall Mall. Lower volume and down-trading were offset by pricing and cost savings, with adjusted profit from operations at constant rates of exchange flat on prior year.
- Iran — Kent continued to perform well with higher volume driving an increase in adjusted profit from operations at constant rates of exchange despite a change in excise that was partly borne by the industry.
- Kazakhstan — Rothmans drove an increase in volume and market share. Adjusted profit from operations at constant rates of exchange improved as higher volume more than offset the effect of down-trading.

- Algeria — market share growth drove an increase in volume and adjusted profit from operations at constant rates of exchange.

Liquidity and Capital Resources

The BAT Group's cash inflows derive principally from operating activities. They are supplemented when required by cash flows from financing activities, typically to support acquisitions. The principal sources of liquidity for the BAT Group are cash flows generated from the operating business and proceeds from issuances of debt securities described below under *"— Capital Resources"*. Cash flows from operating activities are believed to be sufficient for the foreseeable future to fund the BAT Group's activities.

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

The BAT Group board of directors reviews and agrees the overall treasury policies and procedures, delegating appropriate oversight to the Finance Director and the treasury function. The treasury 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 BAT Group. Such instruments are only used if they relate to an underlying exposure; speculative transactions are expressly forbidden under the BAT Group's treasury policy. The BAT 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.

In the six-month periods ended June 30, 2017 and 2016 and in the years 2016, 2015 and 2014, all contractual borrowing covenants were met and none is expected to inhibit the BAT Group's operations or funding plans.

Cash Flow

	Six Months Ended June 30,[1]		Year Ended December 31,[1]		
	2017	2016	2016	2015	2014
			(£ millions)		
Cash generated from operations	1,788	1,350	4,893	5,400	4,634
Dividends received from associates	465	324	962	593	515
Tax paid	(547)	(620)	(1,245)	(1,273)	(1,433)
Net cash generated from operating activities	1,706	1,054	4,610	4,720	3,716
Net cash used in investing activities	(297)	(220)	(640)	(3,991)	(470)
Net cash used in financing activities	(1,511)	(1,051)	(4,229)	(219)	(3,467)
Net cash flows used in operating, investing and financing activities	(102)	(217)	(259)	510	(221)
Differences on exchange	(139)	(53)	180	(272)	(63)
Increase/(decrease) in net cash and cash equivalents in the period	(241)	(270)	(79)	238	(284)
Opening net cash and cash equivalents[2]	1,651	1,730	1,730	1,492	1,776
Closing net cash and cash equivalents[2]	1,410	1,460	1,651	1,730	1,492
Other data:					
Total borrowings	20,907	20,231	19,495	17,001	12,258
Free cash flow[3]	1,083	559	3,389	3,481	2,507
Net debt[4]	18,481	17,735	16,767	14,794	10,165

Notes:

(1) The financial data above has been extracted from the BAT Group's consolidated financial statements and the BAT Group's unaudited condensed consolidated financial statements included in this Offering Memorandum. The financial data for the six months ended June 30, 2017 and 2016 is unaudited. See further discussion at "*Presentation of Financial Information and Other Data*".

(2) In the BAT Group cash flow statement, net cash and cash equivalents are shown after deducting bank overdrafts and accrued interest where applicable. See note 18 to the BAT Group's 2016 consolidated financial statements and note 19 to the BAT Group's 2015 consolidated financial statements included in this Offering Memorandum.

(3) Free cash flow is a non-IFRS measure. See "*Summary Historical Consolidated Financial Data of BAT*" for additional information about free cash flow, as well as a reconciliation to net cash generated from operating activities.

(4) Net debt is a non-IFRS measure. See "*Summary Historical Consolidated Financial Data of BAT*" for additional information about net debt, as well as a reconciliation to total borrowings.

Net Cash Generated from Operating Activities

Net cash generated from operating activities increased by £652 million, or 61.9%, from £1,054 million in the six months ended June 30, 2016 to £1,706 million in the six months ended June 30, 2017, principally due to cash generated from operations. Broadly in line with the movement in net cash generated from operating activities, free cash flow increased in the six months ended June 30, 2017 by £524 million to £1,083 million. Net debt increased by £746 million in the six months ended June 30, 2017, largely due to an increase in borrowings.

Net cash generated from operating activities decreased by £110 million, or 2.3%, to £4,610 million in 2016, principally due to the FII GLO receipts of £963 million in 2015 that did not recur in 2016, partially offset by the decrease in trade and other receivables of £87 million (2015: increase in trade and other receivables of £508 million). For details on the FII GLO receipts, see note 6(b) to the BAT Group's consolidated financial statements included in this Offering Memorandum. Broadly in line with the movement in net cash generated from operating activities, free cash flow decreased in 2016 by £92 million, or 2.6%, to £3,389 million, as free cash flow was impacted by the FII GLO receipts in 2015 that did not recur in 2016. Net debt increased by £1,973 million in 2016, largely due to exchange rate effects, including movements in respect of debt-related derivatives, of £1,684 million.

Net cash generated from operating activities increased by £1,004 million, or 27.0%, to £4,720 million in 2015, driven principally by FII GLO receipts of £963 million in 2015. Free cash flow increased in 2015 by £974 million, or 38.9%, to £3,481 million, predominantly due to the FII GLO receipts of £963 million in 2015 and the settlements of non-tobacco litigation in 2014. Net debt increased by £4,629 million in 2015, principally due to the investment in RAI, the buy-out of non-controlling interests in Souza Cruz and the acquisition of TDR in Croatia.

Net Cash Used in Investing Activities

Net cash used in investing activities increased by £77 million, or 35.0%, to £297 million in the six months ended June 30, 2017 compared to £220 million to the six months ended June 30, 2016. This increase was largely due to an increase in purchases of property, plant and equipment. Net cash used in investing activities decreased by £3,351 million, or 84.0%, to £640 million in 2016 compared to £3,991 million to 2015. This decrease was largely due to cash outflows of £3,508 million related to investments in associates and the acquisitions of subsidiaries in 2015. In 2015, net cash used in investing activities increased by £3,521 million, up from £470 million in 2014. The increase was largely attributable to cash outflows of £3,508 million related to investments in associates and the acquisitions of subsidiaries in 2015.

In the six months ended June 30, 2017, cash outflows from investment in associates and acquisition of subsidiaries totaled £52 million. In 2016, cash outflows from investment in associates and acquisition of subsidiaries totaled £57 million, primarily due to the acquisition of Ten Motives Limited and 10 Motives Limited, a UK based e-cigarette business. Cash flows from investment in associates and acquisitions of subsidiaries of £3,508 million in 2015 resulted from £3,015 million invested into RAI to maintain the BAT Group's percentage holding of approximately 42%, and from cash outflows of £493 million resulting from business combinations during the year. In October 2015, the BAT Group acquired TDR d.o.o., a cigarette manufacturer in Central Europe, for cash consideration of £404 million. In December 2015, BAT acquired CHIC, an e-cigarette business based in Poland, for £52 million and Blue Nile Cigarette Company Limited, a cigarette business based in the Republic of Sudan, for £37 million. In 2014, there was £nil million cash outflow related to investment in associates and acquisition of subsidiaries.

Purchases of and proceeds on disposals of investments include a net cash outflow in respect of current investments of £5 million in the six months ended June 30, 2017, compared to £67 million in the six months ended June 30, 2016. This was largely due to an increase in proceeds on disposals of investments. Purchases of and proceeds on disposals of investments include a net cash outflow in respect of current investments of £87 million in 2016, compared to a net cash outflow of £54 million for 2015 and a net cash inflow of £3 million in 2014.

Net Cash Used in Financing Activities

Net cash used in financing activities increased by £460 million in the six months ended June 30, 2017 to £1,511 million, up from £1,051 million in the six months ended June 30, 2016. This increase was largely attributable to an increase in reductions in and repayments of borrowings, partially offset by proceeds from increases in and new borrowings. Net cash used in financing activities increased by £4,010 million in 2016 to £4,229 million, up from £219 million in 2015. This increase was largely attributable to a decrease in proceeds from increases in and new borrowings of £3,455 million in 2016, as well as an increase in cash outflows from

reductions in and repayments of borrowings of £1,812 million in 2016. In 2015, net cash used in financing activities decreased by £3,248 million, down from £3,467 million in 2014. This decrease was principally due to cash inflows from the proceeds from increases in and new borrowings, which totaled £6,931 million in 2015 compared to £1,967 million in 2014. Those cash inflows were partially offset by cash outflows related to the purchases of non-controlling interests of £1,677 million in 2015, and an increase in the reductions in and repayments of borrowings of £728 million from 2014 to 2015.

In the six months ended June 30, 2017, the purchase of non-controlling interests led to cash outflows of £nil million. In 2016, the purchase of non-controlling interests led to cash outflows of £70 million, resulting from the acquisition of the remaining minority shares of Souza Cruz S.A. In 2015, the purchase of non-controlling interests of £1,677 million relates to the acquisition of a portion of the non-controlling interest in Souza Cruz S.A. (£1,660 million), part of the non-controlling interest in BAT Chile Operaciones S.A. (£1 million) and part of the non-controlling interests in BAT Central America S.A. (£16 million). In 2014, the purchase of non-controlling interest of £4 million relates to the capital injection to BAT Algérie S.P.A.

Cash outflows related to purchases of the BAT Group's own shares totaled £215 million in the six months ended June 30, 2017, compared to £65 million in the six months ended June 30, 2016. Cash outflows related to purchases of the BAT Group's own shares totaled £64 million in 2016, compared to £46 million in 2015 and £849 million in 2014. In the six months ended June 30, 2017, the outflows resulted from purchases of own shares held in employee share ownership trusts. In 2016 and 2015, the outflows resulted entirely from the purchase of shares to be held in employee share ownership trusts, whereas in 2014, the outflow of £800 million was attributable to BAT's share-buyback program.

Dividends paid during the six months ended June 30, 2017 of £2,285 million, compared to £2,044 million in the six months ended June 30, 2016. Of the total dividends paid in the six months ended June 30, 2017, £2,179 million was paid to the BAT Group's shareholders, compared to £1,950 million in the six months ended June 30, 2016, and £106 million was paid to non-controlling interests in the six months ended June 30, 2017, compared to £94 million in the six months ended June 30, 2016. Dividends paid during 2016 of £3,057 million, compared to £3,005 million in 2015 and £2,961 million in 2014. Of the total dividends paid in 2016, £2,910 million was paid to the BAT Group's shareholders in 2016, compared to £2,770 million in 2015 and £2,712 million in 2014, and £147 million was paid to non-controlling interests in 2016, compared to £235 million in 2015 and £249 million in 2014.

In July 2017, the BAT Group's commercial paper programs were updated and the maximum amounts that could be borrowed were increased to $4 billion and £3 billion from $3 billion and £1 billion, respectively. As of June 30, 2017, a total of £1,432 million of commercial paper was outstanding (compared to a balance of £254 million as of December 31, 2016 and £1,705 million as of June 30, 2016). As of December 31, 2015, a total of £505 million of commercial paper was outstanding (compared to a balance of £160 million as of December 31, 2014).

In March 2016, a $300 million bond was repaid at maturity. In July 2016, B.A.T. International Finance p.l.c., a wholly owned subsidiary of the BAT Group, issued a £500 million 1.750% bond maturing in 2021, with two further bonds issued in September 2016 (a $650 million 1.625% bond maturing in 2019 and a £650 million 2.250% bond maturing in 2052). The BAT Group repaid on maturity a CHF 350 million bond in August 2016 and a £325 million bond in September 2016. On July 19, 2016, the BAT Group exercised the make-whole provision for its $700 million 9.500% bond originally issued in 2008 pursuant to Rule 144A of the Securities Act. The bond was redeemed on August 18, 2016, prior to its original maturity date of November 15, 2018.

In April 2017, the BAT Group arranged short term bilateral facilities with some of its core banks for a total amount of approximately £1.6 billion equivalent. These facilities strengthen the Group's liquidity position and provide alternative sources of cost-effective short-term funding.

In June 2017, a €1,250 million bond and a $600 million bond were repaid at maturity.

In July 2017, following the shareholder vote, the BAT Group drew on its acquisition facility provided by a syndicate of relationship banks: two bridge facilities of $15 billion and $5 billion maturing in 2018 and 2019, respectively (each with two six month extensions at BAT's option), a $2.5 billion term loan maturing in 2020 and a $2.5 billion term loan maturing in 2022.

In addition, effective from the closing date of the merger the BAT Group increased its liquidity backstop with a new two-tranche £5.68 billion revolving credit facility, which consists of a 364-day revolving credit facility of £2.84 billion (with a one-year extension and a one-year term-out option), and a £2.84 billion revolving credit facility maturing in 2021. They replace the BAT Group's £3 billion revolving credit facility, which was undrawn as at June 30, 2017.

Cash and Cash Equivalents

Cash and cash equivalents were £2,204 million, £1,963 million and £1,818 million at December 31, 2016, 2015 and 2014, respectively.

	Year Ended December 31,[1]		
	2016	2015	2014
Functional currency	1,748	1,679	1,559
U.S. dollar	195	167	115
Euro	159	50	47
Other currency	102	67	97
Cash and cash equivalents	**2,204**	**1,963**	**1,818**

Notes:

(1) The financial data above has been extracted from the BAT Group's consolidated financial statements included in this Offering Memorandum.

Cash and cash equivalents were £2,019 million at June 30, 2017.

Capital Expenditure

Gross capital expenditures include purchases of property, plant and equipment and purchases of intangibles. Gross capital expenditures for the six-month periods ended June 30, 2017 and 2016 were £210 million and £149 million, respectively. The BAT Group's gross capital expenditures for 2016, 2015 and 2014 were £652 million, £591 million and £689 million, respectively, representing investment in the BAT Group's global operational infrastructure (including, but not limited to, the manufacturing network, trade marketing and IT systems).

Research and Development

The BAT Group spent £144 million in 2016, £148 million in 2015 and £154 million in 2014 on research and development, with a focus on products that could potentially reduce the risk associated with smoking conventional cigarettes.

Hedging Instruments

As discussed in note 23 to the BAT Group's 2016 consolidated financial statements and in note 24 to the BAT Group's 2015 consolidated financial statements included in this Offering Memorandum, the BAT Group hedges its exposure to interest rate movements and currency movements. BAT's cash flow hedges are principally in respect of sales or purchases of inventory and certain debt instruments. A certain number of forward foreign currency contracts were used to manage the currency profile of external borrowings. Interest rate swaps have been used to manage the interest rate profile of external borrowings, while cross currency swaps have been used to manage the currency profile of external borrowings.

Capital Resources

Policy

It is the BAT Group's policy to maximize financial flexibility and minimize refinancing risk by issuing debt with a range of maturities, generally matching projected cash flows, and obtaining this financing from a wide range of providers. The BAT Group has a target average centrally managed debt maturity of at least five years with no more than 20% of centrally managed debt maturing in a single rolling 12 months. As of June 30, 2017, the average centrally managed debt maturity was 8.5 years and the highest proportion of centrally managed debt maturing in a single rolling 12 months was 19.7%. The BAT Group continues to maintain an investment-grade credit rating. On January 17, 2017, Moody's Investors Service downgraded its rating of the BAT Group to Baa2 (stable outlook) and on January 23, 2017, Standard & Poor's Ratings Services downgraded its rating of the BAT Group to BBB+ (stable outlook).

The BAT Group defines capital as net debt and equity. As discussed in note 23 to the BAT Group's 2016 consolidated financial statements and in note 24 to the BAT Group's 2015 consolidated financial statements included in this Offering Memorandum, the only externally imposed capital requirement the BAT Group has is in respect of its centrally managed banking facilities, which require a gross interest cover of 4.5 times. BAT targets a gross interest cover, as calculated under its key central banking facilities, of greater than 5 times. For 2016 it is 12.2 times, compared to 11.6 times in 2015 and 12.0 times in 2014.

The BAT Group utilizes cash pooling and zero balancing bank account structures in addition to intercompany loans and borrowings to ensure that there is the maximum mobilization of cash within the BAT Group. The key objectives of treasury in respect of cash and cash equivalents, are to protect the principal value of the BAT Group's cash and cash equivalents, to concentrate cash at the center to minimize the required long-term debt issuance and to optimize the yield earned. The amount of debt the BAT Group issues is determined by forecasting the net debt requirement after the mobilization of cash.

Subsidiary companies are funded by share capital and retained earnings, loans from the central finance companies on commercial terms, or through local borrowings by the subsidiaries in appropriate currencies. All contractual borrowing covenants have been met and none are expected to inhibit the BAT Group's operations or funding plans.

Borrowings

The following table sets out the BAT Group's long- and short-term borrowings as of the dates indicated:

			As of December 31,[1]		
	Currency	Maturity dates	2016	2015	2014
Eurobonds[4]	Euro	2017 to 2045	7,704	6,603	5,211
	Euro	2018	341	294	309
	UK pound sterling	2019 to 2055	4,241	3,413	3,083
	U.S. dollar	2019	527	203	192
	Swiss franc[2]	2016	—	238	226
	Swiss franc	2021 to 2026	526	446	419
U.S. dollar bonds[4]	U.S. dollar	2017 to 2025	4,472	4,208	1,726
	U.S. dollar	2018	405	339	—
Commercial Paper[3][4]			254	505	160
Other loans			110	236	223
Bank loans			336	258	374
Bank Overdrafts			553	232	325
Finance leases			26	26	10
Total			19,495	17,001	12,258

Notes:

(1) The financial data above has been extracted from the BAT Group's consolidated financial statements included in this Offering Memorandum.

(2) The Swiss franc bonds with a maturity date of 2016 referred to above had an interest rate of 3m CHF LIBOR+ 16 basis points prior to their repayment in 2016.

(3) The interest on the commercial paper referred to in the table above is based on U.S.$ LIBOR plus a margin ranging between 22 and 77 basis points for 2016 (2015: between 25 and 43 basis points, 2014: between 10 and 43 basis points).

(4) The issuer of these debt securities is B.A.T. International Finance p.l.c. British American Tobacco p.l.c. is the ultimate guarantor.

On July 25, 2017, BAT acceded as a guarantor under the indentures of its indirect, wholly owned subsidiaries RAI and RJR Tobacco Company. The securities issued under these indentures include approximately $12.7 billion aggregate principal amount of unsecured RAI debt securities and approximately $284 million aggregate principal amount of unsecured RJR Tobacco Company debt securities. See "*Management's Discussion and Analysis of Financial Condition and Results of Operations of RAI — Long-Term Debt*".

On August 2, 2017, RAI became a guarantor of existing unsecured debt securities issued by BATIF in the aggregate principal amount of approximately $5.4 billion.

On August 2, 2017, RAI also became a guarantor of all securities issued and to be issued under the Euro Medium Term Note Programme. This guarantee by RAI will automatically be released if at any time the aggregate amount of indebtedness for borrowed money (subject to certain carve-outs) for which RAI is an obligor (as a guarantor of a borrower) does not exceed 10% of the outstanding long-term debt of BAT (as such requirements may be modified from time to time in accordance with the applicable provisions of the Euro Medium Term Note Programme).

Litigation and Settlements

As discussed in note 28 to the BAT Group's 2016 consolidated financial statements and in note 30 to the BAT Group's 2015 consolidated financial statements included in this Offering Memorandum, various legal proceedings or claims are pending or may be instituted against the BAT Group. See note 28 to the BAT Group's 2016 consolidated financial statements and note 30 to the BAT Group's 2015 consolidated financial statements included in this Offering Memorandum and "*Business of BAT — Legal Proceedings*".

Governmental Activity

The marketing, sale, taxation and use of tobacco products have been subject to substantial regulation by government and health officials for many years. For information about risks related to regulation, see "*Business — Regulation*".

Related Party Transactions

As discussed in note 27 to the BAT Group's 2016 consolidated financial statements and in note 29 to the BAT Group's 2015 consolidated financial statements included in this Offering Memorandum, the BAT Group has a number of transactions and relationships with related parties, all of which are undertaken in the normal course of business. See note 27 to the BAT Group's 2016 consolidated financial statements and note 29 to the BAT Group's 2015 consolidated financial statements included in this Offering Memorandum.

Off-Balance Sheet Arrangements and Contractual Commitments

Except for operating leases, the BAT Group has no significant off-balance sheet arrangements. The BAT Group has contractual obligations to make future payments on debt agreements. In the normal course of business, the BAT Group enters into contractual arrangements where the BAT Group commits to future purchases of services from unaffiliated and related parties.

The BAT Group's contractual obligations as of December 31, 2016 were as follows:

	Payments Due by Period				
	Total	Less than 1 Year	1-3 Years	3-5 Years	Thereafter
			(£ millions)		
Long-term notes and other borrowings, exclusive of interest[(1)]	19,334	2,789	3,142	3,465	9,938
Interest payments related to long-term notes[(1)]	5,156	798	948	788	2,621
Finance lease obligations	26	10	10	6	—
Operating lease obligations[(2)]	240	64	74	52	50
Purchase obligations[(3)]	2,291	1,613	630	48	—
Total cash obligations	27,047	5,274	4,804	4,359	12,610

Notes:

(1) For more information about the BAT Group's long-term debt, see note 20 to the BAT Group's 2016 consolidated financial statements and note 21 to the BAT Group's 2015 consolidated financial statements included in this Offering Memorandum.

(2) Operating lease obligations represent estimated lease payments primarily related to vehicles, office space, warehouse space and equipment. See note 28 to the BAT Group's 2016 consolidated financial statements and note 30 to the BAT Group's 2015 consolidated financial statements included in this Offering Memorandum.

(3) Purchase obligations primarily include commitments to acquire tobacco leaf. Purchase orders for the purchase of other raw materials and other goods and services are not included in the table, as the BAT Group's operating subsidiaries are not able to determine the aggregate amount of such purchase orders that represent contractual obligations, as purchase orders typically represent authorizations to purchase rather than binding agreements.

The table above does not include any amounts that the BAT Group may pay to fund its retirement benefit plans as the timing and amount of any such future fundings are unknown and dependent on, among other things, the future performance of defined benefit pension plan assets, interest rate assumptions and other factors. The net retirement benefit scheme liabilities totaled £371 million as of December 31, 2016, which is net of pension assets of £455 million. The BAT Group expects to be required to contribute £173 million to its defined benefit plans during 2017. These expected contributions do not include any expected amounts related to RAI. See note 12 to the BAT Group's consolidated financial statements included in this Offering Memorandum.

Dividends and Dividend Policy

The BAT board of directors' dividend policy is to ensure that the BAT shareholders benefit from the successful growth of the business, while continuing to provide sufficient funds to invest in future growth. The BAT Group's dividend policy is to pay dividends of 65% of long-term sustainable earnings, calculated with reference to the adjusted diluted earnings per share. Currently, in relation to interim dividends, the BAT board of directors' policy is that the interim dividend will be approximately one-third of the total dividends declared for the previous financial year. Beginning in 2018, BAT will pay four interim quarterly dividends with respect to BAT ordinary shares and BAT ADSs. BAT will announce the dividend amount as part of its preliminary results announcement for the year ending December 31, 2017 in February 2018 and the dividend amount will be paid in four equal installments in May 2018, August 2018, November 2018 and February 2019. As part of the transition

to quarterly dividend payments, and to ensure BAT shareholders receive the equivalent amount of total cash payments in 2018 as they would have under the previous payment policy, an additional interim dividend will be announced in December 2017 for payment in February 2018 and will be calculated as 25% of the total cash dividend paid in 2017.

The BAT Group board of directors has declared an interim dividend of 56.5 pence per share, being one-third of the total 2016 dividend, to be paid on September 28, 2017. With the approved final dividend of 118.1 pence, the total dividends per share for 2016 are 169.4 pence, compared to a total dividend of 154.0 pence in 2015 and 148.1 pence for 2014. This leads to a total dividend growth of 10.0%, compared to 4.0% in 2015 and 4% in 2014, and a pay-out ratio of 68.4% for 2016, compared to 74% in 2015 and 71.2% in 2014.

Critical Accounting Estimates

The BAT Group presents the discussion and analysis of its financial condition and results of operations based upon its consolidated financial information, which are prepared in accordance with IFRS.

In order to prepare the BAT Group's consolidated financial information in accordance with the accounting policies set out therein, management has used 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 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 budgeted cash flows of these 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 to the BAT Group's consolidated financial statements included in this Offering Memorandum;
- 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 recognized in other comprehensive income, involves judgments made in conjunction with independent actuaries. These involve estimates about uncertain future events based on the environment in different countries, including life expectancy of scheme members, salary and pension increases, inflation, as well as discount rates and asset values at the year end. The assumptions the BAT Group uses and its sensitivity analysis are described in note 12 to the BAT Group's consolidated financial statements included in this Offering Memorandum;
- the estimation of amounts to be recognized 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 in note 1 to the BAT Group's consolidated financial statements included in this Offering Memorandum. The recognized deferred tax assets and liabilities, together with a note of unrecognized amounts, are shown in note 13 to the BAT Group's consolidated financial statements included in this Offering Memorandum, and a contingent tax asset is explained in note 6(b) to the BAT Group's consolidated financial statements included in this Offering Memorandum. Other provisions for liabilities and charges are as set out in note 21 to the BAT Group's 2016 consolidated financial statements and note 22 to the BAT Group's 2015 consolidated financial statements included in this Offering Memorandum. The accounting policy on contingent liabilities, which are not provided for, is set out in note 1 to the BAT Group's consolidated financial statements included in this Offering Memorandum, and the BAT Group's contingent liabilities are explained in note 28 to the BAT Group's 2016 consolidated financial statements and in note 30 to the BAT Group's 2015 consolidated financial statements included in this Offering Memorandum. The application of these accounting policies to the payments made and credits recognized under the MSA by RAI is described in note 5(b) to the BAT Group's consolidated financial statements included in this Offering Memorandum;
- the identification and quantification of adjusting items as defined by the BAT Group's accounting policy as explained within note 1 of the BAT Group's consolidated financial statements included in this Offering Memorandum (see also "*Summary Historical Consolidated Financial Data of BAT*");
- the estimation of the fair values of acquired net assets arising in a business combination and the allocation of the purchase consideration between the underlying net assets acquired, including intangible assets other than goodwill, on the basis of their fair values. These estimates are prepared in conjunction with the advice of independent valuation experts, where appropriate. The relevant transactions are described in notes 24 and 11 to the BAT Group's consolidated financial statements included in this Offering Memorandum;

- the determination as to whether control (subsidiaries), joint control (joint arrangements), or significant influence (associates) exists in relation to the investments held by the BAT Group. This is assessed after taking into account the BAT Group's ability to appoint directors to the entity's board, its relative shareholding compared with other shareholders, any significant contracts or arrangements with the entity or its other shareholders and other relevant facts and circumstances. The application of this judgment in respect of the BAT Group's investment in RAI is explained in note 11 to the BAT Group's consolidated financial statements included in this Offering Memorandum; and
- the review of applicable exchange rates for transactions with and translation of entities in territories where there are restrictions on the free access to foreign currency, or multiple exchange rates.

Such estimates and assumptions are based on historical experience and various other factors that the BAT Group believe to be reasonable in the circumstances and constitute the BAT Group's best judgment as of the date of the BAT Group's consolidated financial statements. In the future, actual experience may deviate from these estimates and assumptions, which could affect such financial statements as the original estimates and assumptions are modified, as appropriate, in the year in which the circumstances change.

The key estimates and assumptions are set out in the accounting policies which can be found at note 1 to the BAT Group's consolidated financial statements included in this Offering Memorandum. Information relating to recently issued accounting guidance can be found at note 1 to the BAT Group's consolidated financial statements included in this Offering Memorandum.

Quantitative and Qualitative Disclosures about Market Risk

Information on the BAT Group's financial risk management policies can be found in note 23 to the BAT Group's 2016 consolidated financial statements and in note 24 to the BAT Group's 2015 consolidated financial statements included in this Offering Memorandum.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS OF RAI

The following discussion and analysis of the RAI's financial condition and results of operations is based on and should be read in conjunction with the RAI's consolidated financial statements and unaudited condensed consolidated financial statements, included in this Offering Memorandum. The RAI Group's consolidated financial statements and the RAI Group's unaudited condensed consolidated financial statements have been prepared in accordance with U.S. GAAP. The consolidated financial statements as of December 31, 2016 and 2015 and for the years ended December 31, 2016, 2015, and 2014 have been audited by KPMG LLP (US) and the condensed consolidated financial statements as of June 30, 2017 and for the six months ended June 30, 2017 and 2016 are unaudited. See further discussion at "Presentation of Financial Information and Other Data".

This discussion and analysis contains certain forward-looking statements which, although based on assumptions that the BAT Group considers reasonable, are subject to risks and uncertainties that could cause actual events or conditions to differ materially from those expressed or implied herein. Factors that could cause or contribute to such differences include, but are not limited to, those discussed below and elsewhere in this Offering Memorandum, see particularly "Forward-Looking Statements" and "Risk Factors".

The financial information and related discussion and analysis contained in this section are presented in U.S. dollars, and many of the amounts and percentages have been rounded for convenience of presentation.

Overview

RAI, the parent company of the RAI Group, is a holding company whose wholly owned operating subsidiaries include the second largest tobacco company in the United States, RJR Tobacco Company; SFNTC, the manufacturer and marketer of the Natural American Spirit brand of cigarettes and other tobacco products in the United States; the second largest smokeless tobacco products manufacturer in the United States, American Snuff Company; R. J. Reynolds Vapor Company, a marketer of digital vapor cigarettes in the United States; Niconovum USA, Inc. and Niconovum AB, marketers of nicotine replacement therapy products in the United States and Sweden, respectively; and until their sale on January 13, 2016, SFRTI and various foreign subsidiaries affiliated with SFRTI, distributors and marketers of the Natural American Spirit brand of cigarettes and other tobacco products outside the United States.

On July 25, 2017, RAI became an indirect, wholly owned subsidiary of BAT after the consummation of the merger.

Overview and Business Initiatives

For the periods under discussion, RAI's reportable operating segments were RJR Tobacco, Santa Fe and American Snuff. The RJR Tobacco segment consists of the primary operations of R. J. Reynolds Tobacco Company. The Santa Fe segment consists of the primary operations of SFNTC. The American Snuff segment consists of the primary operations of American Snuff Co. Included in All Other, among other RAI subsidiaries, are RJR Vapor, Niconovum USA, Inc., Niconovum AB, and until their sale on January 13, 2016, SFRTI and various foreign subsidiaries affiliated with SFRTI. The segments were identified based on how RAI's chief operating decision maker allocates resources and assesses performance. Certain of RAI's operating subsidiaries have entered into intercompany agreements for products or services with other subsidiaries. As a result, certain activities of an operating subsidiary may be included in a different segment of RAI.

RAI has two wholly owned subsidiaries that provide support services to certain of its operating subsidiaries, RAI Services Company providing, among others, legal, finance, information management and human resource services and RAI Trade Marketing Services Company providing trade marketing services, pursuant to intercompany service agreements.

RAI's strategy continues to focus on transforming tobacco to deliver sustainable earnings growth and strong cash flow. This transformation strategy includes growing the core cigarette and moist-snuff businesses, focusing on innovation and engaging with adult tobacco consumers, while maintaining efficient and effective operations.

To achieve its strategy, RAI encourages the migration of adult smokers to smokeless tobacco products and other non-combustible nicotine-containing products, which it believes aligns consumer preferences for new alternatives to traditional tobacco products in view of societal pressure to reduce smoking. RAI's operating companies facilitate this migration through innovation, including the development of digital vapor cigarettes, Camel Snus, heat-not-burn cigarettes and nicotine replacement therapy technologies. RAI remains committed to maintaining high standards of corporate governance and business conduct in a high-performing culture.

RAI's largest reportable operating segment, RJR Tobacco, is the second largest tobacco company in the United States. RJR Tobacco's brands include three of the top four best-selling cigarettes in the United States: Newport, Camel and Pall Mall. These brands, and its other brands, including Doral, Misty and Capri are manufactured in a variety of styles and marketed in the United States. As part of its total tobacco strategy, RJR Tobacco offers a smokeless tobacco product, Camel Snus. RJR Tobacco manages contract manufacturing of cigarette and tobacco products through arrangements with BAT affiliates, and manages the export of tobacco products to U.S. territories, U.S. duty-free shops and U.S. overseas military bases. In the United States, RJR Tobacco also manages the premium cigarette brands Dunhill, which RJR Tobacco Company licenses from the BAT Group, and State Express 555, which RJR Tobacco Company licenses from CTBAT, a joint venture between the BAT Group and CNTC.

Santa Fe manufactures and markets premium cigarettes and other tobacco products under the Natural American Spirit brand in the United States.

American Snuff is the second largest smokeless tobacco products manufacturer in the United States, and offers adult tobacco consumers a range of differentiated smokeless tobacco products, primarily moist snuff. The moist snuff category is divided into premium, price-value and popular-price brands. American Snuff's primary brands include its largest selling moist snuff brands, Grizzly, in the price-value category, and Kodiak, in the premium category.

RJR Tobacco

RJR Tobacco primarily conducts business in the highly competitive U.S. cigarette market, which has a few large manufacturers and many smaller participants. The international rights to substantially all of RJR Tobacco's brands were sold in 1999 to JTI, and no international rights were acquired in connection with the B&W business combination in 2004 or the Lorillard merger in 2015. The U.S. cigarette market is a mature market in which overall adult consumer demand has declined since 1981, and is expected to continue to decline. Profitability of the U.S. cigarette industry and RJR Tobacco continues to be adversely impacted by decreases in consumption, increases in state excise taxes and governmental regulations and restrictions, such as marketing limitations, product standards and ingredients legislation.

RJR Tobacco's cigarette brand portfolio strategy is based upon two brand categories: drive and other. The drive brands consist of two premium brands, Newport and Camel, and the largest traditional value brand in the United States, Pall Mall. These three brands are managed for long-term market share and profit growth, and receive the vast majority of RJR Tobacco's equity support with an emphasis on the Newport and Camel brands. The other brand category includes the premium brand, Capri, and the value brands, Doral and Misty, along with other smaller brands. All of the other brands receive limited marketing support and are managed to maximize profitability.

The key objectives of the portfolio strategy are designed to balance the long-term market share growth and profitability of the drive brands while managing the other brands for long-term sustainability and profitability. Consistent with that strategy, RJR Tobacco continues to evaluate some of its non-core cigarette styles for potential elimination.

RJR Tobacco's portfolio also includes Camel Snus, a smokeless, heat-treated tobacco product sold in individual pouches that provide convenient tobacco consumption.

Competition is based primarily on brand positioning, including price, product attributes and packaging, consumer loyalty, promotions, advertising and retail presence, as well as finding efficient and effective means of balancing market share and profit growth. Cigarette brands produced by the major manufacturers generally require competitive pricing, substantial marketing support, retail programs and other incentives to maintain or improve market position or to introduce a new brand or brand style. Competition among the major cigarette manufacturers continues to be highly competitive and includes product innovation and expansion into smokeless tobacco categories.

RJR Tobacco is committed to building and maintaining a portfolio of profitable brands. RJR Tobacco's marketing programs are designed to strengthen brand image, build brand awareness and loyalty, and switch adult smokers of competing brands to RJR Tobacco brands. In addition to building strong brand equity, RJR Tobacco's marketing approach utilizes a retail pricing strategy, including discounting at retail, to defend certain brands' shares of market against competitive pricing pressure. RJR Tobacco's competitive pricing methods may include list price changes, discounting programs, such as retail and wholesale buydowns, periodic price reductions, off-invoice price reductions, dollar-off promotions and consumer coupons. Retail buydowns refer to payments made to the retailer to reduce the price that consumers pay at retail. Consumer coupons are distributed by a variety of methods.

Santa Fe

Santa Fe manufactures and markets premium cigarettes and other tobacco products under the Natural American Spirit brand in the United States. Competition in the cigarette category is based primarily on brand positioning, including price, product attributes and packaging, consumer loyalty, promotions, advertising and retail presence.

American Snuff

American Snuff offers adult tobacco consumers a range of differentiated smokeless tobacco products, primarily moist snuff, with its Grizzly and Kodiak brands. The moist snuff category is divided into premium, price-value and popular-price brands. The highly competitive moist snuff category has developed many of the characteristics of the larger, cigarette market, including multiple pricing tiers, focused marketing programs and significant product innovation.

In contrast to the declining U.S. cigarette market, U.S. moist snuff retail volumes grew approximately 2.0% in the twelve months ended June 30, 2017. Profit margins on moist snuff products are generally higher than on cigarette products. Moist snuff's growth is partially attributable to cigarette smokers switching from cigarettes to smokeless tobacco products or using both.

American Snuff faces significant competition in the smokeless tobacco category. Similar to the cigarette market, competition is based primarily on brand positioning and price, as well as product attributes and packaging, consumer loyalty, promotions, advertising and retail presence.

All Other

RJR Vapor markets VUSE Digital Vapor Cigarette products, which include VUSE Solo, VUSE Fob and VUSE Vibe. VUSE is the top-selling vapor product in convenience/gas stores and is available in more than 110,000 retail outlets across the United States. Its innovative digital technology is designed to deliver a consistent flavor and vapor experience. In March 2016, RJR Vapor introduced its VUSE Fob power unit, which integrates Bluetooth® technology and offers an on-device display with information about battery and cartridge levels. RJR Vapor began national distribution, in November 2016, of its VUSE Vibe high-volume cartridge and closed-tank system with a stronger and longer-lasting battery. All production of VUSE Solo cartridges is performed at RJR Tobacco's manufacturing facility, pursuant to a services agreement between RJR Tobacco Company and RJR Vapor.

In January 2016, RAI, through various subsidiaries, completed the sale of the international rights to the Natural American Spirit brand name and associated trademarks, along with SFRTI and other international companies that distributed and marketed the brand outside the United States, to JTI Holding, in an all-cash transaction of approximately $5 billion and recognized a pre-tax gain of approximately $4.9 billion. The sale did not include the rights to the Natural American Spirit brand name and associated trademarks in the U.S. market, U.S. duty-free locations, and U.S. territories or in U.S. military outlets, all of which were retained by SFNTC. With this transaction completed, the international rights to nearly all of RAI's operating companies' cigarette trademarks are now owned by international tobacco companies, including in some instances, subsidiaries of the BAT Group.

Niconovum USA, Inc. is a marketer of a nicotine replacement therapy gum, Zonnic, which is available in approximately 40,000 retail outlets across the United States. Niconovum AB is a marketer of nicotine replacement therapy products in Sweden under the Zonnic brand name.

Merger with BAT

Pursuant to the terms of the merger agreement, upon completion of the merger on July 25, 2017, RAI became an indirect, wholly owned subsidiary of BAT. As a result of the merger, shares of RAI common stock are no longer publicly traded. At the effective time of the merger, each share of RAI common stock (other than any shares of RAI common stock owned by BAT or any of its subsidiaries, RAI or any of its subsidiaries and by shareholders of RAI who properly asserted and did not lose or effectively withdraw appraisal rights) was converted into the right to receive the merger consideration, without interest, and subject to adjustment to prevent dilution. For more information on the merger, see note 14 to the RAI Group's unaudited condensed consolidated financial statements included in this Offering Memorandum.

Critical Accounting Estimates

U.S. GAAP requires estimates and assumptions to be made that affect the reported amounts in RAI's consolidated financial statements and accompanying notes. Some of these estimates require difficult, subjective

and/or complex judgments about matters that are inherently uncertain, and as a result, actual results could differ from those estimates. Due to the estimation processes involved, the following summarized accounting policies and their application are considered to be critical to understanding the business operations, financial position and results of operations of RAI and its subsidiaries. For information related to these and other significant accounting policies, see note 1 to the RAI Group's consolidated financial statements included in this Offering Memorandum.

Litigation

RAI discloses information concerning litigation for which an unfavorable outcome is more than remote. RAI and its subsidiaries record their legal expenses and other litigation costs and related administrative costs as selling, general and administrative expenses as those costs are incurred. RAI and its subsidiaries will record any loss related to litigation at such time as an unfavorable outcome becomes probable and the amount can be reasonably estimated on an individual case-by-case basis. When the reasonable estimate is a range, the recorded loss will be the best estimate within the range. If no amount in the range is a better estimate than any other amount, the minimum amount of the range will be recorded.

Reynolds Defendants have been named in a number of tobacco-related legal actions, proceedings or claims seeking damages in amounts ranging into the hundreds of millions or even billions of dollars. Unfavorable judgments have been returned in a number of tobacco-related cases and state enforcement actions. For further discussion of the litigation and legal proceedings pending against RAI or its affiliates or indemnitees, see note 7 to the RAI Group's unaudited condensed consolidated financial statements included in this Offering Memorandum.

State Settlement Agreements

RJR Tobacco Company (itself, and as successor by merger to Lorillard Tobacco) and SFNTC are participants in the MSA, and RJR Tobacco Company (itself, and as successor by merger to Lorillard Tobacco) is a participant in the other state settlement agreements. Their obligations and the related expense charges under these agreements are subject to adjustments based upon, among other things, the volume of cigarettes sold by the operating subsidiaries, their relative market share, their operating profits and inflation. Since relative market share is based on cigarette shipments, the best estimate of the allocation of charges to RJR Tobacco Company and SFNTC under these agreements is recorded in cost of products sold as the products are shipped. Adjustments to these estimates are recorded in the period that the change becomes probable and the amount can be reasonably estimated. American Snuff Co. is not a participant in the State Settlement Agreements. For additional information related to the State Settlement Agreements, see "*— Litigation Affecting the Cigarette Industry — Health-Care Cost Recovery Cases — State Settlement Agreements"* and *"— State Settlement Agreements-Enforcement and Validity; Adjustments*" in note 7 to the RAI Group's unaudited condensed consolidated financial statements included in this Offering Memorandum.

Pension and Postretirement Benefits

RAI sponsors a number of non-contributory defined benefit pension plans covering certain employees of RAI and its subsidiaries. RAI and a subsidiary provide health and life insurance benefits for certain retired employees of RAI and its subsidiaries and their dependents. These benefits are generally no longer provided to employees hired on or after January 1, 2004.

Because pension and other postretirement obligations ultimately will be settled in future periods, the determination of annual benefit cost (income) and liabilities is subject to estimates and assumptions. RAI reviews these assumptions annually or coincidental with a major event based on historical experience and expected future trends and modifies them as needed. Demographic assumptions, such as termination of employment, mortality and retirement date, are reviewed periodically as expectations change.

Actuarial (gains) losses are changes in the amount of either the benefit obligation or the fair value of plan assets resulting from experience different from that assumed or from changes in assumptions. Actuarial (gains) losses are immediately recognized in the operating results in the year in which they occur, to the extent the net (gains) losses are in excess of 10% of the greater of the fair value of plan assets or benefit obligations referred to as the corridor. Net (gains) losses outside the corridor generally are recognized annually as of December 31, or when a plan is remeasured during an interim period, and are recorded as an MTM adjustment. Additionally, for the purpose of calculating the expected return on plan assets, RAI uses the actual fair value of plan assets.

Prior service costs (credits) of pension benefits, which are changes in benefit obligations due to plan amendments, are amortized on a straight-line basis over the average remaining service period for active employees, or average remaining life expectancies for inactive employees if most of the plan obligations are due

to inactive employees. Prior service costs (credits) of postretirement benefits, which are changes in benefit obligations due to plan amendments, are amortized on a straight-line basis over the expected service period to full eligibility age for active employees, or average remaining life expectancies for inactive employees if most of the plan obligations are due to inactive employees.

Intangible Assets

Intangible assets include goodwill, trademarks and other intangible assets. The determination of fair value involves considerable estimates and judgment. Intangible assets with indefinite lives are tested annually for impairment in the fourth quarter or more frequently if events and circumstances indicate that an impairment may have occurred.

For goodwill, the determination of fair value of a reporting unit involves, among other things, RAI's market capitalization, and application of the income approach, which includes developing forecasts of future cash flows and determining an appropriate discount rate. If goodwill impairment is implied, the fair values of individual assets and liabilities, including unrecorded intangibles, must be determined. RAI believes it has based its goodwill impairment testing on reasonable estimates and assumptions, and during the annual testing, the estimated fair value of each of RAI's reporting units was substantially in excess of its respective carrying value.

The methodology used to determine the fair value of trademarks includes assumptions with inherent uncertainty, including projected sales volumes and related projected revenues, long-term growth rates, royalty rates that a market participant might assume and judgments regarding the factors to develop an applied discount rate. The carrying value of intangible assets is at risk of impairment if future projected revenues or long-term growth rates are lower than those currently projected, or if factors used in the development of a discount rate result in the application of a higher discount rate.

Goodwill, trademarks and other intangible assets are tested more frequently if events and circumstances indicate that the asset might be impaired. The carrying value of these intangible assets could be impaired if a significant adverse change in the use, life or brand strategy of the asset is determined, or if a significant adverse change in the legal and regulatory environment, business or competitive climate occurs that would adversely impact the asset. For information related to intangible assets, see note 2 to the RAI Group's unaudited condensed consolidated financial statements included in this Offering Memorandum.

Fair Value Measurement

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, essentially an exit price. RAI determines fair value of assets and liabilities using a fair value hierarchy that distinguishes between market participant assumptions based on market data obtained from sources independent of the reporting entity, and the reporting entity's own assumptions about market participant assumptions based on the best information available in the circumstances.

For information on assets and liabilities recorded at fair value, see note 1 to the RAI Group's unaudited condensed consolidated financial statements included in this Offering Memorandum.

Income Taxes

Income tax law requires certain items to be excluded or included in taxable income at different times than is required for book reporting purposes. These differences may be permanent or temporary in nature.

RAI determines its annual effective income tax rate based on forecasted pre-tax book income and forecasted permanent book and tax differences. The rate is established at the beginning of the year and is evaluated on a quarterly basis. Any changes to the forecasted information may cause the effective rate to be adjusted. Additional tax, interest and penalties associated with uncertain tax positions are recognized in tax expense on a quarterly basis.

To the extent that any book and tax differences are temporary in nature, that is, the recognition and measurement of assets and liabilities under the tax law may differ from recognition and measurement under GAAP, a deferred tax asset or liability is recorded. To the extent that a deferred tax asset is recorded, management evaluates RAI's ability to realize this asset. A valuation allowance is required for deferred tax assets if, based on available evidence, it is more likely than not that all or some portion of the assets will not be realized.

The financial statements reflect management's best estimate of RAI's current and deferred tax liabilities and assets. Future events, including, but not limited to, additional resolutions with taxing authorities could have an

impact on RAI's current estimate of tax liabilities, realization of deferred tax assets and effective income tax rate. For information on income taxes, see note 5 to the RAI Group's unaudited condensed consolidated financial statements included in this Offering Memorandum.

Recently Adopted and Issued Accounting Pronouncements

For information relating to recently adopted and issued accounting pronouncements, see note 1 to the RAI Group's unaudited condensed consolidated financial statements included in this Offering Memorandum.

Results of Operations

RJR Tobacco's net sales and operating income include the Winston, Kool and Salem brands until the date of their sale on June 12, 2015, and the Newport, Kent, Old Gold and True brands beginning June 12, 2015. All Other net sales and operating income include SFRTI and the various foreign subsidiaries affiliated with SFRTI, until the date of their sale on January 13, 2016.

	For the Six Months Ended June 30,			For the Twelve Months Ended December 31,				
	2017	2016	% Change	2016	2015	% Change	2014	% Change
Net sales:[1]								
RJR Tobacco	$5,046	$ 5,057	(0.2)%	$10,314	$ 8,634	19.5%	$6,767	27.6%
Santa Fe	516	465	11.0%	973	818	18.9%	658	24.3%
American Snuff	503	448	12.3%	914	855	6.9%	783	9.2%
All Other	202	142	42.3%	302	368	(17.9)%	263	39.9%
Net sales	6,267	6,112	2.5%	12,503	10,675	17.1%	8,471	26.0%
Cost of products sold[1][2]	2,477	2,440	1.5%	4,841	4,688	3.3%	4,058	15.5%
Selling, general and administrative expenses	896	964	(7.1)%	1,931	2,098	(8.0)%	1,871	12.1%
Gain on divestiture	—	(4,861)	NM[3]	(4,861)	(3,181)	52.8%	—	NM[3]
Amortization expense	12	12	—	23	18	27.8%	11	63.6%
Asset impairment and exit charges	—	—	—	—	99	NM[3]	—	NM[3]
Operating income (loss):								
RJR Tobacco	2,374	2,323	2.2%	4,922	3,359	46.5%	2,173	54.6%
Santa Fe	313	256	22.3%	546	449	21.6%	337	33.2%
American Snuff	326	271	20.3%	541	502	7.8%	438	14.6%
All Other	(48)	(77)	37.7%	(145)	(265)	(45.3)%	(234)	13.2%
Gain on divestitures	—	4,861	NM[3]	4,861	3,181	52.8%	—	NM[3]
Corporate expense	(83)	(77)	(7.8)%	(156)	(273)	(42.9)%	(183)	49.2%
Operating income	$2,882	$ 7,557	(61.9)%	$10,569	$ 6,953	52.0%	$2,531	NM[3]

(1) Excludes excise taxes of:

	For the Six Months Ended June 30,		For the Twelve Months Ended December 31,		
	2017	2016	2016	2015	2014
RJR Tobacco	$1,893	$1,979	$3,997	$3,590	$3,068
Santa Fe	144	139	287	254	211
American Snuff	28	27	54	54	53
All Other	—	5	5	311	293
	$2,065	$2,150	$4,343	$4,209	$3,625

(2) See below for further information related to State Settlement Agreements, FDA user fees and federal tobacco buyout included in cost of products sold, as applicable.

(3) Percentage of change not meaningful.

In the following discussion, the amounts presented in the operating companies' shipment volume and share tables are rounded on an individual basis and, accordingly, may not sum in the aggregate. Percentages are calculated on unrounded numbers.

The Six Months Ended June 30, 2017 Compared with the Six Months Ended June 30, 2016

RJR Tobacco

Net Sales

Domestic cigarette shipment volume, in billions of units for RJR Tobacco and the industry, was as follows:

	For the Six Months Ended June 30,		
	2017	2016	% Change
RJR Tobacco:			
Drive brands:			
Newport	16.6	16.9	(1.7)%
Camel	9.5	10.0	(5.3)%
Pall Mall	8.9	9.4	(6.0)%
Total RJR Tobacco drive brands	35.0	36.4	(3.8)%
Other brands	2.6	3.0	(11.4)%
Total RJR Tobacco domestic cigarette shipment volume	37.6	39.3	(4.4)%
Total premium	26.9	27.8	(3.3)%
Total value	10.7	11.5	(7.0)%
Premium/total mix	71.6%	70.8%	
Industry[(1)]:			
Premium	90.2	92.8	(2.8)%
Value	33.7	34.9	(3.5)%
Total industry domestic cigarette shipment volume	123.8	127.7	(3.0)%
Premium/total mix	72.8%	72.7%	

(1) Based on information from MSAi.

RJR Tobacco's net sales are dependent upon its cigarette shipment volume in a declining market, premium versus value-brand mix and list pricing, offset by promotional spending, trade incentives and federal and state excise taxes.

RJR Tobacco's net sales for the six months ended June 30, 2017, decreased compared with the prior-year period, primarily due to lower related party sales and lower net volume/product mix of $220 million, offset by higher net pricing of $271 million.

Market Share

The shares of RJR Tobacco's cigarette brands as a percentage of total share of U.S. cigarette shipments to retail outlets, referred to as STR data, based on information submitted by wholesale locations and processed and managed by MSAi , were as follows:

	For the Six Months Ended		
	June 30, 2017	June 30, 2016	Share Point Change
Drive brands:			
Newport	14.1%	13.9%	0.1
Camel	8.2%	8.2%	(0.0)
Pall Mall	7.6%	7.8%	(0.2)
Total drive brands	29.9%	29.9%	0.0
Other brands	2.3%	2.4%	(0.2)
Total RJR Tobacco domestic cigarette share of retail shipments	32.2%	32.4%	(0.2)

The retail share of market of Newport, at 14.1 share points, was up 0.1 share point compared with the prior-year period in the highly competitive U.S. cigarette category. Newport's cigarette market share continued to be favorably impacted by its strength in the menthol category, as well as its continued momentum in the non-menthol category.

The retail share of market of Camel, at 8.2 share points, was flat compared with the prior-year period in the highly competitive U.S. cigarette category. Camel's cigarette market share demonstrated relatively stable performance in the six months across its menthol styles that offer its innovative capsule technology in Camel Crush. Camel Crush styles provide adult smokers the choice of switching from non-menthol to menthol. Camel Snus, a smokeless tobacco product, continues to lead the U.S. snus category with a market share of over 75%.

Pall Mall is a product that offers a high quality, longer-lasting cigarette at a value price. Pall Mall continues to attract interest from adult tobacco consumers in spite of competitive pressures, yielding a market share of 7.6%, for the first six months of 2017, which was down slightly compared with the prior-year period.

The combined share of market of RJR Tobacco's drive brands during the six months ended June 30, 2017 was flat compared with the prior-year period. RJR Tobacco's total cigarette market share was down slightly compared with the same period in the prior year, primarily due to decreases in the company's other brands, consistent with its strategy of focusing on drive brands.

Operating Income

RJR Tobacco's operating income for the six-month period ended June 30, 2017, was favorably impacted by higher pricing, partially offset by lower net volume/product mix and higher State Settlement Agreement expenses when compared with the prior-year period.

RJR Tobacco Company's expenses under the State Settlement Agreements and its FDA user fees included in cost of products sold were:

	For the Six Months Ended June 30,	
	2017	**2016**
State Settlement Agreements	$1,399	$1,272
FDA user fees	86	92

Expenses under the State Settlement Agreements are expected to be approximately $2.8 billion in 2017, subject to adjustment based upon, among other things, the volume of cigarettes sold by RJR Tobacco, its relative market share, its operating profits and inflation. Pursuant to the Term Sheet, RJR Tobacco Company will receive credits with respect to its NPM Adjustment claims to be applied against annual payments under the MSA through 2021. An additional two states joined the Term Sheet in the second quarter of 2017, and as a result, expenses for the MSA were reduced by $17 million for the six months ended June 30, 2017.

As a result of meeting the performance requirements associated with the Term Sheet, RJR Tobacco Company recognized credits of $26 million and $143 million for the six months ended June 30, 2017 and 2016, respectively. RJR Tobacco Company expects to recognize additional credits through the remainder of 2017.

In October 2015, RJR Tobacco Company and certain other PMs entered into the NY Settlement Agreement to settle certain claims related to the NPM Adjustment. The NY Settlement Agreement resolved NPM Adjustment claims related to payment years from 2004 through 2014, providing RJR Tobacco Company with credits of approximately $285 million, plus interest, subject to meeting various performance obligations. These credits will be applied against annual payments under the MSA over a four-year period, which commenced with the April 2016 MSA payment. Accordingly, RJR Tobacco Company recognized credits of $48 million and $45 million as a reduction to cost of products sold for the six months ended June 30, 2017 and 2016, respectively. In addition, the NY Settlement Agreement put in place a new method to determine future adjustments from 2015 forward as to New York.

For additional information, see "— *Cost of Products Sold*" in note 1 and "— *Litigation Affecting the Cigarette Industry — Health-Care Cost Recovery Cases — State Settlement Agreements*" and "— *State Settlement Agreements — Enforcement and Validity; Adjustments*" in note 7 to the RAI Group's unaudited condensed consolidated financial statements included in this Offering Memorandum.

Expenses for FDA user fees are expected to be approximately $160 million to $190 million in 2017. For additional information, see "— *Governmental Activity*" below.

Selling, general and administrative expenses include the costs of litigating and administering product liability claims, as well as other legal expenses. RJR Tobacco Company's product liability defense costs were $105 million and $109 million for the six months ended June 30, 2017 and 2016, respectively.

"Product liability" cases generally include the following types of smoking and health related cases:

- Individual Smoking and Health;
- West Virginia IPIC;
- *Engle* Progeny;
- *Broin II*;
- Class Actions;
- Filter Cases; and
- Health-Care Cost Recovery Claims.

"Product liability defense costs" include the following items:

- direct and indirect compensation, fees and related costs and expenses for internal legal and related administrative staff administering the defense of product liability claims;
- fees and cost reimbursements paid to outside attorneys;
- direct and indirect payments to third party vendors for litigation support activities; and
- expert witness costs and fees.

Numerous factors affect product liability defense costs. The most important factors are the number of cases pending and the number of cases in trial or in preparation for trial, that is, with active discovery and motions practice. See "*— Litigation Affecting the Cigarette Industry — Overview*" in note 7 to the RAI Group's unaudited condensed consolidated financial statements included in this Offering Memorandum for detailed information regarding the number and type of cases pending, and "*— Litigation Affecting the Cigarette Industry — Overview — Scheduled Trials*" in note 7 to the RAI Group's unaudited condensed consolidated financial statements included in this Offering Memorandum for detailed information regarding the number and nature of cases in trial and scheduled for trial through June 30, 2018.

RJR Tobacco Company expects that the factors described above will continue to have the primary impact on its product liability defense costs in the future. Given the level of activity in RJR Tobacco Company's pending cases, including the number of cases in trial and scheduled for trial, particularly with respect to *Engle* Progeny cases, RJR Tobacco Company's product liability defense costs continue to remain at a high level. See "*— Litigation Affecting the Cigarette Industry — Engle and Engle Progeny Cases*" in note 7 to the RAI Group's unaudited condensed consolidated financial statements included in this Offering Memorandum for additional information.

In addition, it is possible that other adverse developments in the factors discussed above, as well as other circumstances beyond the control of RJR Tobacco, could have a material adverse effect on the consolidated results of operations, cash flows or financial position of RAI or its subsidiaries. Those other circumstances beyond the control of RJR Tobacco include the results of present and future trials and appeals, and the development of possible new theories of liability by plaintiffs and their counsel.

Santa Fe

Net Sales

Domestic cigarette shipment volume, in billions of units, for Santa Fe was as follows:

	For the Six Months Ended June 30,		
	2017	2016	% Change
Natural American Spirit	2.7	2.6	4.0%

Santa Fe's net sales for the six-month period ended June 30, 2017, increased compared with the prior-year period, primarily due to higher volume and net pricing.

Market Share

The shares of Santa Fe's Natural American Spirit brand as a percentage of total share of U.S. cigarette STR data according to MSAi were as follows:

	For the Six Months Ended June 30,		
	2017	2016	Share Point Change
Natural American Spirit	2.3%	2.1%	0.2

Natural American Spirit is a premium cigarette brand, and is a top ten best-selling cigarette brand in the United States.

Operating Income

Santa Fe's operating income for the six-month period ended June 30, 2017, increased as compared with the prior-year period primarily due to higher volume and net pricing.

Santa Fe's expenses under the MSA and its FDA user fees included in cost of products sold were:

	For the Six Months Ended June 30,	
	2017	2016
MSA	$86	$77
FDA user fees	6	6

Expenses under the MSA are expected to be approximately $170 million to $200 million in 2017, subject to adjustment for changes in volume and other factors.

In October 2015, SFNTC and certain other PMs entered into the NY Settlement Agreement to settle certain claims related to the NPM Adjustment. The NY Settlement Agreement resolved NPM Adjustment claims related to payment years from 2004 through 2014, providing SFNTC with credits of approximately $5 million, plus interest, subject to meeting various performance obligations. These credits will be applied against annual payments under the MSA over a four-year period, which commenced with the April 2016 MSA payment. In addition, the NY Settlement Agreement put in place a new method to determine future adjustments from 2015 forward as to New York.

For additional information, see "— *Cost of Products Sold*" in note 1 and "— *Litigation Affecting the Cigarette Industry — Health-Care Cost Recovery Cases — State Settlement Agreements*" and "— *State Settlement Agreements — Enforcement and Validity; Adjustments*" in note 7 to the RAI Group's unaudited condensed consolidated financial statements included in this Offering Memorandum.

American Snuff

Net Sales

The moist snuff shipment volume, in millions of cans, for American Snuff was as follows:

	For the Six Months Ended June 30,		
	2017	2016	% Change
Grizzly	239.0	228.1	4.8%
Other	21.1	21.1	0.2%
Total American Snuff moist snuff shipment volume	260.1	249.1	4.4%

American Snuff's net sales for the six-month period ended June 30, 2017, increased compared with the same prior-year period primarily due to higher net pricing and higher moist snuff volume.

Market Share

Moist snuff has been the key driver to American Snuff's overall growth and profitability within the U.S. smokeless tobacco market. Moist snuff accounted for approximately 93% of American Snuff's revenue for the six months ended June 30, 2017, compared with approximately 91% for the six months ended June 30, 2016.

The shares of American Snuff's moist snuff brands as a percentage of total share of U.S. moist snuff STR data according to MSAi were as follows:

	For the Six Months Ended June 30,		
	2017	2016	Share Point Change
Grizzly	31.7%	30.6%	1.0
Other	2.6%	2.6%	(0.1)
Total American Snuff moist snuff share of retail shipments	34.2%	33.3%	0.9

The retail market share of Grizzly, a leading U.S. moist snuff brand, increased 1.0 share point in the first six months of 2017, compared with the prior-year period, benefitting from supply disruption of competitive products during the first half of 2017 and the recent national expansion of its Dark Mint style. Grizzly's increase in shipment volume was driven by growth in the wintergreen styles and pouch offerings. Grizzly continues its market-leading position in wintergreen, with long cut and pouch styles remaining strong and the Grizzly Dark Wintergreen style enhancing the Grizzly wintergreen offerings. Grizzly Dark Wintergreen offers a differentiated and bolder wintergreen flavor, and is made from 100% U.S. tobacco grown in Kentucky and Tennessee.

Grizzly continues to show strength with its soft pouch design, which offers adult smokeless tobacco consumers a flavorful, moist experience that is easy to use, positioning it to be the leading pouch brand during the six months ended June 30, 2017. The pouch category represents approximately 20% of the moist snuff industry.

Operating Income

American Snuff's operating income for the six-month period ended June 30, 2017, increased as compared with the prior-year periods primarily due to higher net pricing and volume.

All Other

RJR Vapor markets VUSE Digital Vapor Cigarette products, which include VUSE Solo, VUSE Fob and VUSE Vibe. VUSE is the top-selling vapor product in convenience/gas stores and is available in more than

110,000 retail outlets across the United States. Its innovative digital technology is designed to deliver a consistent flavor and vapor experience. In March 2016, RJR Vapor introduced its VUSE Fob power unit, which integrates Bluetooth® technology and offers an on-device display with information about battery and cartridge levels. RJR Vapor began national distribution, in November 2016, of its VUSE Vibe high-volume cartridge and closed-tank system with a stronger and longer-lasting battery. All production of VUSE Solo cartridges is performed at RJR Tobacco's manufacturing facility, pursuant to a services agreement between RJR Tobacco Company and RJR Vapor.

Niconovum USA, Inc. is a marketer of a nicotine replacement therapy gum, ZONNIC, which is available in approximately 40,000 retail outlets across the United States. Niconovum AB is a marketer of nicotine replacement therapy products in Sweden under the ZONNIC brand name.

Gain on divestiture

The results of operations of SFRTI were reported in All Other until their sale on January 13, 2016. SFRTI and various foreign subsidiaries affiliated with SFRTI distributed the Natural American Spirit brand outside of the United States. RAI, through various subsidiaries, completed the sale of the international rights to the Natural American Spirit brand name and associated trademarks, along with the international companies that distributed and marketed the brand outside the United States, to JTI Holding, in an all-cash transaction for approximately $5 billion in cash and recognized a pre-tax gain of approximately $4.9 billion in the first quarter of 2016.

RAI Consolidated

Interest and debt expense was $299 million for six months ended June 30, 2017, compared with $326 million for the six months ended June 30, 2016. The change for six months ended June 30, 2017, as compared with the prior-year period, is primarily due to a reduction in the aggregate principal amount of $4.2 billion of outstanding notes resulting from the repurchase, early redemption and repayment at maturity of debt in 2016.

Other expense (income), net was $15 million for the six months ended June 30, 2017, compared with $251 million expense for the six months ended June 30, 2016. The change is attributable primarily to approximately $239 million in losses and other fees related to the cash tender offer and the redemption of notes in the first six months of 2016.

Provision for income taxes was $874 million, for an effective tax rate of 34.0%, for the six months ended June 30, 2017, compared with $2.6 billion, for an effective tax rate of 37.6%, for the six months ended June 30, 2016. The effective tax rate for the six months ended June 30, 2017, was primarily impacted by a $29 million decrease in tax attributable to excess tax benefits on stock-based compensation plans and a reduction in state taxes. The effective tax rate for the six months ended June 30, 2016, was primarily impacted by the sale of the international rights to the Natural American Spirit brand name and associated trademarks, along with the international companies that distributed and marketed the brand outside the United States. Additionally, the effective tax rate for each period differed from the federal statutory rate of 35% due to the domestic manufacturing deduction, state income taxes and certain nondeductible items.

2016 Compared with 2015

RJR Tobacco

Net Sales

Domestic cigarette shipment volume, in billions of units, for RJR Tobacco and the industry, was as follows:

	For the Twelve Months Ended December 31,		
	2016	2015	% Change
RJR Tobacco:			
Drive brands:			
Newport	34.4	18.9	NM[(2)]
Camel	20.3	20.8	(2.2)%
Pall Mall	18.9	19.9	(5.2)%
Total RJR Tobacco drive brands	73.5	59.5	23.5%
Other brands	5.9	11.8	(50.0)%
Total RJR Tobacco domestic cigarette shipment volume	79.4	71.3	11.3%
Total premium	56.5	47.0	20.1%
Total value	23.0	24.3	(5.6)%
Premium/total mix	71.1%	65.9%	

	For the Twelve Months Ended December 31,		
	2016	2015	% Change
Industry[1]:			
RJR Tobacco:			
Premium	187.4	190.3	(1.5)%
Value	70.6	74.0	(4.6)%
Total industry domestic cigarette shipment volume	258.0	264.3	(2.4)%
Premium/total mix	72.6%	72.0%	

(1) Based on information from MSAi.

(2) Percentage of change not meaningful.

RJR Tobacco's net sales are dependent upon its cigarette shipment volume in a declining market, premium versus value-brand mix and list pricing, offset by promotional spending, trade incentives and federal and state excise taxes.

RJR Tobacco's net sales for the year ended December 31, 2016, increased from the year ended December 31, 2015, primarily due to higher volume and favorable product mix of $1.3 billion and higher net pricing of $490 million.

Market Share

Market share information is included for RJR Tobacco to provide enhanced analysis of its brand performance. For brands that were acquired in the Lorillard merger, share information is displayed as if the brands were part of the portfolio for all time periods shown. Brands that were part of the Lorillard Divestiture have been removed for all presented time periods. Accordingly, this pro forma market share data is presented for informational purposes only and is not necessarily indicative of what the market share of the acquired brands would have been if the Lorillard merger and Lorillard Divestiture had occurred at the beginning of the periods presented, nor is it necessarily indicative of future market share.

The shares of RJR Tobacco's cigarette brands as a percentage of total share of U.S. cigarette STR data were as follows:

	For the Twelve Months Ended December 31,		
	2016[1]	2015	Share Point Change
Drive brands:			
Newport	13.9%	13.5%	0.4
Camel	8.2%	8.3%	(0.1)
Pall Mall	7.7%	7.9%	(0.3)
Total drive brands	29.9%	29.7%	0.1
Other brands	2.4%	2.6%	(0.2)
Total RJR Tobacco domestic cigarette retail share of market	32.3%	32.3%	(0.1)

(1) In 2016, the universe of industry participants that MSAi uses to estimate RJR Tobacco's cigarette shipments to retail market share has been revised to reflect the new universe of direct customers as a result of the Lorillard merger. The revision results in higher absolute share levels in 2015 on some of RJR Tobacco's brands, but does not affect overall share trends. Prior-year market share data, herein, has been restated on this basis for comparison purposes.

The retail share of market of Newport, at 13.9 share points, was up 0.4 share points compared with the prior-year period in the highly competitive U.S. cigarette category. Newport's cigarette market share continued to be favorably impacted by its strength in the menthol category, as well as its continued momentum in the non-menthol category.

The retail share of market of Camel, at 8.2 share points, was down 0.1 share points compared with the prior-year period in the highly competitive U.S. cigarette category. Camel's cigarette market share demonstrated relatively stable performance in its menthol styles that offer its innovative capsule technology offered in Camel Crush. Camel Crush styles provide adult smokers the choice of switching from non-menthol to menthol. Camel Crush menthol styles allow adult smokers to choose the level of menthol flavor on demand. Camel Snus, a smoke-free tobacco product, continues to lead the U.S. snus category with a market share of approximately 75%.

Pall Mall, a product that offers a high quality, longer-lasting cigarette at a value price, continues to attract interest from adult tobacco consumers. Pall Mall's 2016 market share of 7.7% was down 0.3 share points compared with the prior-year period due to continued competitive pressure.

The combined share of market of RJR Tobacco's drive brands during 2016 was up slightly compared with 2015. RJR Tobacco's total cigarette market share was down slightly from the prior year due to increases in the company's drive brands, offset by decreases in the company's other brands, consistent with its strategy of focusing on drive brands.

Operating Income

RJR Tobacco's operating income for the year ended December 31, 2016, increased from the year ended December 31, 2015, primarily due to higher volume, higher cigarette pricing and favorable product mix. The results for the year ended December 31, 2016, include a full year net benefit from the Lorillard merger and Lorillard Divestiture compared with approximately six months in 2015. In addition, the MTM adjustment expense in 2016 was $42 million compared with an MTM adjustment expense of $229 million in 2015. The 2016 MTM adjustment was driven primarily by a decrease in the discount rate partially offset by the impact of assumption changes and better than expected asset returns. The 2015 MTM adjustment was primarily a result of lower than expected asset returns partially offset by an increase in the discount rate.

RJR Tobacco Company's expense under the State Settlement Agreements and its FDA user fees included in cost of products sold were:

	For the Twelve Months Ended December 31,	
	2016	**2015**
State Settlement Agreements	$2,563	$2,254
FDA user fees	179	162

Expenses under the State Settlement Agreements are expected to be approximately $2.8 billion in 2017, subject to adjustment based upon, among other things, the volume of cigarettes sold by RJR Tobacco, its relative market share, its operating profits and inflation. Pursuant to the Term Sheet, RJR Tobacco Company will receive credits with respect to its NPM Adjustment claims to be applied against annual payments under the MSA through 2018.

As a result of meeting the performance requirements associated with the Term Sheet, RJR Tobacco Company recognized credits of $295 million and $279 million for the years ended December 31, 2016 and 2015, respectively. RJR Tobacco Company expects to recognize additional credits through 2017.

In September 2013, the Arbitration Panel ruled six states had not diligently enforced their qualifying statutes in 2003 related to the NPM Adjustment. Two of the six states subsequently joined the Term Sheet in 2014. In 2015, three of the states dropped their challenge of the finding of non-diligence and in 2016, the remaining state dropped its challenge. As such, a portion of the potential recovery from those states was certain and estimable, and RJR Tobacco Company recognized $6 million and $93 million as a reduction of cost of products sold for the years ended December 31, 2016 and 2015, respectively. A final issue regarding the judgment reduction method adopted by the Arbitration Panel was being contested in these four states. In 2016, the U.S. Supreme Court denied RJR Tobacco Company's petition for writ of certiorari against two states, thus eliminating RJR Tobacco Company's remaining recovery from these states. The final outcome in the remaining two states is uncertain.

In October 2015, RJR Tobacco Company and certain other PMs entered into a settlement agreement, referred to as the NY Settlement Agreement, with the State of New York to settle certain claims related to the NPM Adjustment. The NY Settlement Agreement resolved NPM Adjustment claims related to payment years from 2004 through 2014, providing RJR Tobacco Company with credits of approximately $285 million, plus interest, subject to meeting various performance obligations. These credits will be applied against annual payments under the MSA over a four-year period, which commenced with the April 2016 MSA payment. Accordingly, RJR Tobacco Company recognized credits of $93 million and $14 million as a reduction to cost of products sold for the years ended December 31, 2016 and 2015, respectively. In addition, the NY Settlement Agreement put in place a new method to determine future adjustments from 2015 forward as to New York.

For additional information, see "— *Cost of Products Sold*" in note 1 and "— *Litigation Affecting the Cigarette Industry — Health-Care Cost Recovery Cases — State Settlement Agreements*" and "— *State Settlement Agreements — Enforcement and Validity; Adjustments*" in note 13 to the RAI Group's consolidated financial statements included in this Offering Memorandum.

Expenses for FDA user fees are expected to be approximately $160 million to $190 million in 2017. For additional information, see "*Business of RAI — Governmental Activity*".

Selling, general and administrative expenses include the costs of litigating and administering product liability claims, as well as other legal expenses. For the years ended December 31, 2016 and 2015, RJR Tobacco Company's product liability defense costs were $208 million and $198 million, respectively.

"Product liability" cases generally include the following types of smoking and health related cases:

- Individual Smoking and Health;
- West Virginia IPIC;
- *Engle* Progeny;
- *Broin II*;
- Class Actions;
- Filter Cases; and
- Health-Care Cost Recovery Claims.

"Product liability defense costs" include the following items:

- direct and indirect compensation, fees and related costs and expenses for internal legal and related administrative staff administering the defense of product liability claims;
- fees and cost reimbursements paid to outside attorneys;
- direct and indirect payments to third party vendors for litigation support activities; and
- expert witness costs and fees.

Numerous factors affect product liability defense costs. The most important factors are the number of cases pending and the number of cases in trial or in preparation for trial, that is, with active discovery and motions practice. See "*— Litigation Affecting the Cigarette Industry — Overview — Introduction*" in note 13 to the RAI Group's consolidated financial statements included in this Offering Memorandum for detailed information regarding the number and type of cases pending, and "*— Litigation Affecting the Cigarette Industry — Overview — Scheduled Trials*" in note 13 to the RAI Group's consolidated financial statements included in this Offering Memorandum for detailed information regarding the number and nature of cases in trial and scheduled for trial through December 31, 2017.

RJR Tobacco Company expects that the items described above will continue to comprise its product liability defense costs in the future. Given the level of activity in RJR Tobacco Company's pending cases, including the number of cases in trial and scheduled for trial, particularly with respect to the *Engle* Progeny cases, RJR Tobacco Company's product liability defense costs are expected to remain at a high level. See "*— Litigation Affecting the Cigarette Industry — Engle and Engle Progeny Cases*" in note 13 to the RAI Group's consolidated financial statements included in this Offering Memorandum for additional information.

In addition, it is possible that other adverse developments in the items discussed above, as well as other circumstances beyond the control of RJR Tobacco, could have a material adverse effect on the consolidated results of operations, cash flows or financial position of RAI or its subsidiaries. Those other circumstances beyond the control of RJR Tobacco include the results of present and future trials and appeals, and the development of possible new theories of liability by plaintiffs and their counsel.

Santa Fe

Net Sales

Domestic cigarette shipment volume, in billions of units, for Santa Fe was as follows:

	For the Twelve Months Ended December 31,		
	2016	**2015**	**% Change**
Natural American Spirit	5.4	4.8	13.6%

Santa Fe's net sales for the year ended December 31, 2016, increased over 2015 primarily due to higher volume and higher net pricing.

Market Share

The shares of Santa Fe's Natural American Spirit cigarette brand as a percentage of total share of U.S. cigarette STR data were as follows:

	For the Twelve Months Ended December 31,		
	2016[1]	**2015**	**Share Point Change**
Natural American Spirit	2.2%	1.9%	0.3

(1) In 2016, the universe of industry participants that MSAi uses to estimate Santa Fe's cigarette shipments to retail market share has been revised to reflect the new universe of direct customers as a result of the Lorillard merger. The revision results in higher absolute share levels in 2015 on some of Santa Fe's brand styles, but does not affect overall share trends. Prior-year market share data, herein, has been restated on this basis for comparison purposes.

Natural American Spirit continues to be the fastest growing super-premium cigarette brand in the industry as the product resonates with adult tobacco consumers looking for an authentic brand founded on principles of quality.

Operating Income

Santa Fe's operating income for the year ended December 31, 2016, increased as compared with the prior-year period primarily due to higher volume and higher net pricing.

Santa Fe's expense under the MSA and its FDA user fees, included in cost of products sold were:

	For the Twelve Months Ended December 31,	
	2016	2015
MSA	$164	$140
FDA user fees	13	10

Expenses under the MSA are expected to be approximately $175 million to $205 million in 2017, subject to adjustment for changes in volume and other factors.

In October 2015, SFNTC and certain other PMs entered into the NY Settlement Agreement to settle certain claims related to the NPM Adjustment. The NY Settlement Agreement resolved NPM Adjustment claims related to payment years from 2004 through 2014, providing SFNTC with credits of approximately $5 million, plus interest, subject to meeting various performance obligations. These credits will be applied against annual payments under the MSA over a four-year period, which commenced with the April 2016 MSA payment. In addition, the NY Settlement Agreement put in place a new method to determine future adjustments from 2015 forward as to New York.

For additional information, see "— *Cost of Products Sold*" in note 1 and "— *Litigation Affecting the Cigarette Industry — Health-Care Cost Recovery Cases — State Settlement Agreements*" and "— *State Settlement Agreements — Enforcement and Validity; Adjustments*" in note 13 to the RAI Group's consolidated financial statements included in this Offering Memorandum.

American Snuff

Net Sales

The moist snuff shipment volume, in millions of cans, for American Snuff was as follows:

	For the Twelve Months Ended December 31,		
	2016	2015	% Change
Grizzly	460.6	454.4	1.4%
Other	42.4	44.7	(5.2)%
Total American Snuff moist snuff shipment volume	502.9	499.1	0.8%

American Snuff's net sales for the year ended December 31, 2016, increased compared with the prior-year period primarily due to higher net pricing and higher moist snuff volume.

Moist snuff has been the key driver to American Snuff's overall growth and profitability within the U.S. smokeless tobacco market. Moist snuff accounted for approximately 91% of American Snuff's revenue in 2016 and approximately 90% in 2015.

Market Share

The shares of American Snuff's moist snuff brands as a percentage of total share of U.S. moist snuff STR data were as follows[(1)]:

	For the Twelve Months Ended December 31,		
	2016	2015	Share Point Change
Grizzly	30.8%	30.9%	(0.1)
Other	2.6%	2.8%	(0.2)
Total American Snuff moist snuff retail share of market	33.4%	33.7%	(0.3)

(1) In 2016, the universe of industry participants that MSAi uses to estimate American Snuff's moist snuff shipments to retail market share has been revised to reflect the new universe of direct customers as a result of the Lorillard merger. The revision results in higher absolute share levels in 2015 on some of American Snuff's brands, but does not affect overall share trends. Prior-year market share data, herein, has been restated on this basis for comparison purposes.

Grizzly, a leading U.S. moist snuff brand, declined 0.1 share points in 2016 in a significantly competitive marketplace. Grizzly's increase in full-year shipment volume was driven by growth in the wintergreen styles and pouch offerings. Grizzly continues its market-leading position in wintergreen, with long cut and pouch styles remaining strong and the Grizzly Dark Wintergreen style enhancing the Grizzly wintergreen offerings. Grizzly Dark Wintergreen offers a differentiated and bolder wintergreen flavor, and is made from 100% U.S. tobacco grown in Kentucky and Tennessee.

Grizzly continues to show strength with its soft pouch design, which offers smokeless tobacco consumers a flavorful, moist experience that is easy to use, positioning it to be the fastest growing leading pouch brand. The pouch category represents approximately 20% of the moist snuff industry.

In September 2016, Grizzly expanded its product offerings with the national launch of Premium Dark Mint. This style offers 100% dark-fired U.S. tobacco with mint flavor.

Operating Income

American Snuff's operating income for the year ended December 31, 2016, increased compared with the prior-year period primarily due to higher net pricing and higher moist snuff volume.

All Other

RJR Vapor is the marketer of VUSE Digital Vapor Cigarette products. Since the fourth quarter of 2015, all production of VUSE Solo cartridges is performed at RJR Tobacco's manufacturing facility, pursuant to a services agreement between RJR Tobacco Company and RJR Vapor. As a result of this consolidation, pre-tax asset impairment and exit charges of $99 million were recorded in All Other in the third quarter of 2015. For additional information, see note 6 to the RAI Group's consolidated financial statements included in this Offering Memorandum.

Gain on divestitures

The results of operations of SFRTI were reported in All Other until their sale on January 13, 2016. SFRTI and various foreign subsidiaries affiliated with SFRTI distributed the Natural American Spirit brand outside the United States. RAI, through various subsidiaries, completed the sale of the international rights to the Natural American Spirit brand name and associated trademarks, along with the international companies that distributed and marketed the brand outside the United States, to JTI Holding in an all-cash transaction for approximately $5 billion and recognized a pre-tax gain of approximately $4.9 billion in the first quarter of 2016. See note 3 to the RAI Group's consolidated financial statements included in this Offering Memorandum.

For the year ended December 31, 2015, the $3.2 billion pre-tax gain is a result of the divestiture of the Winston, Kool and Salem cigarette brands, previously owned by RAI subsidiaries, as well as the cigarette brand Maverick and the "e-vapor" brand blu (including Skycig), previously owned by Lorillard subsidiaries, and other assets and certain liabilities. For additional information, see note 2 to the RAI Group's consolidated financial statements included in this Offering Memorandum.

Corporate Expense

Corporate operating costs and expenses decreased for the year ended December 31, 2016, compared with 2015, primarily due to a lower MTM adjustment expense in 2016, and costs associated with the Lorillard merger and Lorillard Divestiture in 2015.

RAI Consolidated

Interest and debt expense for the year ended December 31, 2016, increased $56 million compared with the prior period. The change is primarily due to costs associated with the notes issued to fund part of the merger consideration in the Lorillard merger and the notes assumed from Lorillard Tobacco in connection with the Lorillard merger, offset by decreases in interest and debt expenses related to the repurchase and redemption during the first six months of 2016 of approximately $3.7 billion of outstanding notes, and the repayment at maturity in August 2016 of approximately $500 million of outstanding notes. RAI expects that interest expense will be lower in future periods, compared with prior periods due to the retirement of debt that occurred in 2016.

Provision for income taxes reflected an effective rate of 37.3%, for the year ended December 31, 2016, compared with an effective rate of 49.0%, for the year ended December 31, 2015. The effective tax rate for 2016 was impacted by the sale of the international rights to the Natural American Spirit brand name and associated trademarks, along with the international companies that distributed and marketed the brand outside the

United States. The effective tax rate for 2015 was unfavorably impacted by an increase in tax attributable to nondeductible acquisition costs, nondeductible goodwill in the amount of $1,849 million associated with the Lorillard merger and Lorillard Divestiture and an increase in uncertain tax positions, offset by a decrease in tax attributable to the release of valuation allowance and a reduction in state income taxes.

The effective tax rate for each period differed from the federal statutory rate of 35% due to the domestic manufacturing deduction of the American Jobs Creation Act of 2004, state income taxes and certain nondeductible items.

RAI expects its effective tax rate to be between 36.5% and 37.5% in 2017.

2015 Compared with 2014

RJR Tobacco

Net Sales

Domestic cigarette shipment volume, in billions of units, for RJR Tobacco and the industry, was as follows:

	For the Twelve Months Ended December 31,		
	2015	**2014**	**% Change**
RJR Tobacco:			
Drive brands:			
Newport	18.9	—	NM[2]
Camel	20.8	20.9	(0.5)%
Pall Mall	19.9	20.6	(3.4)%
Total RJR Tobacco drive brands	59.5	41.5	43.5%
Other brands:	11.8	19.5	(39.4)%
Total RJR Tobacco domestic cigarette shipment volume	71.3	61.0	17.0%
Total premium	47.0	35.6	32.1%
Total value	24.3	25.4	(4.1)%
Premium/total mix	65.9%	58.4%	
Industry[1]:			
Premium	190.3	189.1	0.7%
Value	74.0	75.5	(2.1)%
Total industry domestic cigarette shipment volume	264.3	264.6	(0.1)%
Premium/total mix	72.0%	71.5%	

(1) Based on information from MSAi.

(2) Percentage of change not meaningful.

RJR Tobacco's net sales for the year ended December 31, 2015, increased from the year ended December 31, 2014, primarily due to higher volume and favorable product mix of $1,614 million and higher net pricing of $238 million.

Market Share

Market share information is included for RJR Tobacco to provide enhanced analysis of its brand performance. For brands that were acquired in the Lorillard merger, share information is displayed as if the brands were part of the portfolio for all time periods shown. Brands that were part of the Lorillard Divestiture have been removed for all presented time periods. Accordingly, this pro forma market share data is presented for informational purposes only and is not necessarily indicative of what the market share of the acquired brands would have been if the Lorillard merger and Lorillard Divestiture had occurred at the beginning of the periods presented, nor is it necessarily indicative of future market share.

The shares of RJR Tobacco's cigarette brands as a percentage of total share of U.S. cigarette STR data were as follows[(1)]:

	For the Twelve Months Ended December 31,		
	2015	2014	Share Point Change
Drive brands:			
Newport	13.4%	12.9%	0.4
Camel	8.2%	8.2%	—
Pall Mall	7.8%	8.1%	(0.3)
Total drive brands	29.4%	29.2%	0.2
Other brands	2.6%	2.9%	(0.3)
Total RJR Tobacco domestic cigarette retail share of market	32.0%	32.1%	(0.1)

(1) In 2016, the universe of industry participants that MSAi uses to estimate RJR Tobacco's cigarette shipments to retail market share was revised to reflect the new universe of direct customers as a result of the Lorillard merger. Data provided herein reflects previously published data using MSAi's historical universe of industry participants prior to the Lorillard merger.

The retail share of market of Newport, at 13.4 share points, was up 0.4 share points compared with prior-year period in the highly competitive U.S. cigarette industry. Newport's cigarette market share continued to be favorably impacted by its strength in the menthol category, as well as its continued momentum in the non-menthol category.

The retail share of market of Camel, at 8.2 share points, was flat compared with the prior-year period in the highly competitive U.S. cigarette category. Camel's cigarette market share continued to be favorably impacted by its innovative capsule technology offered in Camel Crush and Camel Crush menthol styles.

Pall Mall's 2015 market share of 7.8% was down 0.3 share points compared with prior-year period due to continued competitive pressure.

The combined share of market of RJR Tobacco's drive brands during 2015 was up slightly compared with 2014 and the 2015 market share of other brands was down slightly compared with 2014, consistent with its strategy of focusing on drive brands. RJR Tobacco's total cigarette market share was down slightly from the prior year.

Operating Income

RJR Tobacco's operating income for the year ended December 31, 2015, increased from the year ended December 31, 2014, primarily due to higher cigarette pricing, favorable product mix, the expiration of the federal tobacco quota buyout and the lower impact of the MTM adjustment, partially offset by expense associated with the *Engle* Progeny litigation, and inventory valuation and other costs associated with the Lorillard merger. The MTM adjustment expense in 2015 was $229 million, primarily as a result of pension asset returns that were less than expected returns and was partially offset by an increase in the discount rate. The MTM adjustment expense in 2014 was $422 million, which primarily resulted from the adoption of new mortality assumptions.

RJR Tobacco Company's expense under the State Settlement Agreements, FDA user fees and federal tobacco quota buyout, which expired in September 2014, included in cost of products sold, were:

	For the Twelve Months Ended December 31,	
	2015	2014
State Settlement Agreements	$2,254	$1,808
FDA user fees	162	125
Federal tobacco quota buyout	—	151

For the years ended December 31, 2015 and 2014, RJR Tobacco Company recognized credits of $293 million and $341 million, respectively, related to the Term Sheet.

Selling, general and administrative expenses include the costs of litigating and administering product liability claims, as well as other legal expenses. For the years ended December 31, 2015 and 2014, RJR Tobacco Company's product liability defense costs were $198 million and $180 million, respectively.

Santa Fe

Net Sales

Domestic cigarette shipment volume, in billions of units for Santa Fe, was as follows:

	For the Twelve Months Ended December 31,		
	2015	2014	% Change
Natural American Spirit	4.8	3.9	21.4%

Santa Fe's net sales for the year ended December 31, 2015, increased over 2014 primarily due to higher volume and higher net pricing. Expansion of the distribution network and sales force contributed to greater awareness of the Natural American Spirit brand and increased interest of adult tobacco consumers.

Market Share

The shares of Santa Fe's Natural American Spirit cigarette brand as a percentage of total share of U.S. cigarette STR data were as follows[(1)]:

	For the Twelve Months Ended December 31,		
	2015	2014	Share Point Change
Natural American Spirit	1.9%	1.5%	0.3

(1) In 2016, the universe of industry participants that MSAi uses to estimate Santa Fe's cigarette shipments to retail market share was revised to reflect the new universe of direct customers as a result of the Lorillard merger. Data provided herein reflects previously published data using MSAi's historical universe of industry participants prior to the Lorillard merger.

Operating Income

Santa Fe's operating income for the year ended December 31, 2015, increased as compared with the prior-year period primarily due to higher volume and higher net pricing.

Santa Fe's expense under the MSA, FDA user fees and federal tobacco quota buyout, which expired in September 2014, included in cost of products sold, were:

	For the Twelve Months Ended December 31,	
	2015	2014
MSA	$140	$108
FDA user fees	10	8
Federal tobacco quota buyout	—	10

As a result of meeting the performance requirements associated with the Term Sheet, Santa Fe recognized credits.

American Snuff

Net Sales

The moist snuff shipment volume, in millions of cans, for American Snuff was as follows:

	For the Twelve Months Ended December 31,		
	2015	2014	% Change
Grizzly	454.4	433.8	4.7%
Other	44.7	44.9	(0.4)%
Total American Snuff moist snuff shipment volume	499.1	478.6	4.3%

American Snuff's net sales for the year ended December 31, 2015, increased compared with the prior-year period primarily due to higher net pricing and higher moist snuff volume.

Moist snuff accounted for approximately 90% of American Snuff's revenue in 2015 and approximately 89% in 2014.

Market Share

The shares of American Snuff's moist snuff brands as a percentage of total share of U.S. moist snuff STR data were as follows[1]:

	For the Twelve Months Ended December 31,		
	2015	2014	Share Point Change
Grizzly	30.7%	30.0%	0.8
Other	2.8%	2.9%	(0.1)
Total American Snuff moist snuff retail share of market	33.5%	32.9%	0.6

(1) In 2016, the universe of industry participants that MSAi uses to estimate American Snuff's moist snuff shipments to retail market share was revised to reflect the new universe of direct customers as a result of the Lorillard merger. Data provided herein reflects previously published data using MSAi's historical universe of industry participants prior to the Lorillard merger.

Grizzly, a leading U.S. moist snuff brand, grew 0.8 share points in 2015 despite significant competitive activity. Grizzly's increase in full-year shipment volume was driven by growth in the wintergreen styles and pouch offerings. The brand expanded distribution of Grizzly Dark Wintergreen in early 2015.

Operating Income

American Snuff's operating income for the year ended December 31, 2015, increased compared with the prior-year period primarily due to higher net pricing and higher moist snuff volume.

All Other

During 2015, RJR Vapor announced that all production of VUSE Solo cartridges will be performed at RJR Tobacco's manufacturing facility, pursuant to a services agreement between RJR Tobacco Company and RJR Vapor. As a result of this consolidation, pre-tax asset impairment and exit charges of $99 million were recorded in All Other in the third quarter of 2015.

Gain on divestitures

The $3.2 billion pre-tax gain in 2015 is a result of the divestiture of the Winston, Kool and Salem cigarette brands, previously owned by RAI subsidiaries, as well as the cigarette brand Maverick and the "e-vapor" brand blu (including Skycig), previously owned by Lorillard subsidiaries, and other assets and certain liabilities. For additional information, see note 2 to the RAI Group's consolidated financial statements included in this Offering Memorandum.

Corporate Expense

Corporate operating costs and expenses increased for the year ended December 31, 2015, compared with 2014, primarily due to costs associated with the Lorillard merger and Lorillard Divestiture.

RAI Consolidated

Interest and debt expense for the year ended December 31, 2015, increased $284 million compared with the prior-year period. The change is primarily due to costs associated with the Lorillard merger.

Provision for income taxes reflected an effective rate of 49.0%, for the year ended December 31, 2015, compared with an effective rate of 36.1%, for the year ended December 31, 2014. The effective tax rate for 2015 was unfavorably impacted by an increase in tax attributable to nondeductible acquisition costs, nondeductible goodwill in the amount of $1,849 million associated with the Lorillard Divestiture and an increase in uncertain tax positions, offset by a decrease in tax attributable to the release of valuation allowance in the amount of $37 million and a reduction in state income tax rates. The effective rate for 2014 was favorably impacted by a decrease in uncertain tax positions related to a federal audit settlement and an increase in the domestic manufacturing deduction, partially offset by an increase in tax attributable to nondeductible acquisition costs.

Income from discontinued operations, net of tax was $25 million for the year ended December 31, 2014. The audit of the 2010 and 2011 tax years by the Internal Revenue Service was closed on February 27, 2014. A tax benefit of $25 million attributable to a decrease in uncertain tax positions was recorded in discontinued operations.

Liquidity and Financial Condition

Liquidity

The principal sources of liquidity for RAI's operating subsidiaries' businesses and operating needs were historically internally generated funds from their operations and intercompany loans and advances. The principal sources of liquidity for RAI, in turn, were historically proceeds from intercompany dividends and distributions, as well as issuances of debt securities and the Credit Agreement described below under "— *Long-Term Debt and Credit Agreement*." With the completion of the merger, through a zero balancing bank account structure, excess cash of RAI and its operating subsidiaries is now invested in the global cash pooling program managed by the BAT Group's treasury team. For the foreseeable future, cash flows from operating activities and intercompany loans and advances from the BAT Group's global cash pooling program are believed to be sufficient to enable RAI and its operating subsidiaries to fund their operations, to meet their obligations under the State Settlement Agreements, to make required debt-service payments, and to fund their capital expenditures.

The negative impact, if any, on the sources of liquidity that could result from a decrease in demand for products due to short-term inventory adjustments by wholesale and retail distributors, changes in competitive pricing, adverse regulatory actions, increases in excise taxes, or adverse impacts from financial markets, cannot be predicted. RAI cannot predict its cash requirements or those of its subsidiaries related to any future settlements or judgments, including cash required to be held in escrow or to bond any appeals, if necessary, and RAI makes no assurance that it or its subsidiaries will be able to generate sufficient funds internally or if adequate funding from the BAT Group will be available to meet all of those requirements.

RAI's operating companies monitor the liquidity of key suppliers and customers, and where liquidity concerns are identified, appropriate contingency or response plans are developed. As of June 30, 2017, no business interruptions have occurred due to key supplier liquidity, and no liquidity issues were identified involving significant suppliers or customers.

Contractual obligations of RAI and its subsidiaries as of December 31, 2016, were as follows:

	Payments Due by Period				
	Total	Less than 1 Year-2017	1-3 Years 2018-2019	4-5 Years 2020-2021	Thereafter
Long-term debt, exclusive of interest[1]	$12,950	$ 500	$2,000	$1,521	$ 8,929
Interest payments related to long-term debt[1]	9,208	649	1,202	982	6,375
Operating leases[2]	27	20	5	2	—
Non-qualified pension obligations[3]	119	11	22	24	62
Postretirement benefit obligations[3]	533	78	115	106	234
Qualified pension funding[3]	100	100			
Purchase obligations[4]	81	81			
Other noncurrent liabilities[5]	31	N/A	11	2	18
State Settlement Agreements' obligations[6]	14,800	2,800	6,000	6,000	
Gross unrecognized income tax benefit[7]	118				
FDA user fee[8]	995	195	400	400	
Total cash obligations	$38,962	$4,434	$9,755	$9,037	$15,618

(1) For more information about RAI's and RJR Tobacco Company's long-term debt, see note 12 to the RAI Group's consolidated financial statements included in this Offering Memorandum.

(2) Operating lease obligations represent estimated lease payments primarily related to vehicles, office space, warehouse space and equipment. See note 13 to the RAI Group's consolidated financial statements included in this Offering Memorandum.

(3) For more information about RAI's pension plans and postretirement benefits, see note 16 to the RAI Group's consolidated financial statements included in this Offering Memorandum. Non-qualified pension and postretirement benefit obligations captioned under "Thereafter" include obligations for a five-year period. These obligations are not reasonably estimable beyond a ten-year period. Qualified pension plan funding is based on the Pension Protection Act of 2006 and tax deductibility and is not reasonably estimable beyond one year.

(4) Purchase obligations primarily include commitments to acquire tobacco leaf. Purchase orders for the purchase of other raw materials and other goods and services are not included in the table. RAI's operating subsidiaries are not able to determine the aggregate amount of such purchase orders that represent contractual obligations, as purchase orders typically represent authorizations to purchase rather than binding agreements. For purposes of this table, contractual obligations for the purchase of goods or services are defined by RAI's operating subsidiaries as agreements that are enforceable and legally binding that specify all significant terms, including fixed or minimum quantities to be purchased; fixed, minimum or variable price provisions; and the approximate timing of the transaction. Purchase orders of RAI's operating subsidiaries are based on current demand expectations and are fulfilled by vendors within short time horizons. RAI's operating subsidiaries do not have significant non-cancelable agreements for the purchase of raw materials or other goods or services specifying minimum quantities or set prices that exceed their expected requirements. RAI's operating subsidiaries also enter into contracts for outsourced services; however, the obligations under these contracts were generally not significant and the contracts generally contain clauses allowing for the cancellation without significant penalty.

(5) Other noncurrent liabilities primarily include long-term disability insurance and bonus compensation. Certain other noncurrent liabilities are excluded from the table above, for which timing of payments are not estimable.

(6) State Settlement Agreements' obligation amounts in the aggregate beyond five years are not presented as these are obligations into perpetuity. For more information about the State Settlement Agreements, see note 13 to the RAI Group's consolidated financial statements included in this Offering Memorandum.

(7) For more information on gross unrecognized income tax benefits, see note 10 to the RAI Group's consolidated financial statements included in this Offering Memorandum. Due to inherent uncertainties regarding the timing of payment of these amounts, RAI cannot reasonably estimate the payment period.

(8) FDA user fee obligation amounts in the aggregate beyond five years are not presented as these obligations are assumed to extend into perpetuity. For more information about FDA user fees, see "*Business of RAI — Governmental Activity*".

Long-Term Debt

RAI Notes

As of June 30, 2017, the aggregate principal amount of RAI's outstanding notes was $12.7 billion, with maturity dates ranging from 2017 to 2045. RAI, at its option, may redeem any or all of its outstanding notes, in whole or in part at any time, subject to the payment of a make-whole premium. Interest on the notes is payable semi-annually. At June 30, 2017, RAI had an aggregate principal amount of $1,697 million of current maturities of long-term debt.

On July 25, 2017, BAT granted a guarantee of RAI's outstanding notes.

RJR Tobacco Company's Notes

As of June 30, 2017, the aggregate principal amount of RJR Tobacco Company's outstanding notes was $284 million, with maturity dates ranging from 2017 to 2041. Interest on the notes is payable semi-annually. At June 30, 2017, RJR Tobacco Company had aggregate principal amount of $53 million of current maturities of long-term debt.

On July 25, 2017, BAT granted a guarantee of RJR Tobacco Company's outstanding notes.

Tender Offer and Redemption

In February 2016, pursuant to its previously announced cash tender offer, RAI accepted for purchase $2.69 billion in aggregate principal amount of certain of its outstanding senior notes. In addition to the payment of accrued and unpaid interest, RAI paid, with cash on hand, aggregate total consideration of $2.81 billion, which included a premium of approximately $118 million for such notes accepted for purchase.

In March 2016, pursuant to its previously announced redemption call, RAI redeemed all $700 million outstanding aggregate principal amount of its 6.750% Senior Notes due 2017 and all $250 million outstanding aggregate principal amount of its 7.750% Senior Notes due 2018. In addition to the payment of accrued and unpaid interest, RAI paid, with cash on hand, aggregate consideration of $1.0 billion for the redemption, which included $88 million of early redemption premiums on such notes.

Credit Agreement

Effective July 25, 2017, in connection with the completion of the merger, RAI terminated the RAI Credit Agreement (defined below). For additional information related to the RAI Credit Agreement termination and the merger, see note 14 to the RAI Group's unaudited condensed consolidated financial statements in this Offering Memorandum. The following information represents a description of the RAI Credit Agreement prior to its termination on July 25, 2017.

In December 2014, RAI entered into a credit agreement referred to as the RAI Credit Agreement with a syndicate of lenders, providing for a five-year, $2 billion senior unsecured revolving credit facility, which could be increased to $2.35 billion at the discretion of the lenders upon the request of RAI. The maturity date of the RAI Credit Agreement had been extended to December 18, 2021.

Certain of RAI's subsidiaries, including its Material Subsidiaries, guaranteed, on an unsecured basis, RAI's obligations under the RAI Credit Agreement.

During the first six months of 2017, RAI borrowed and repaid $500 million under the RAI Credit Agreement at an interest rate of 2.15%. Proceeds from the borrowings were used for general corporate purposes of RAI and its subsidiaries, including making payments under the MSA. As of June 30, 2017, there were no outstanding borrowings and no letters of credit outstanding under the RAI Credit Agreement.

RAI, RJR Tobacco Company and their affiliates were in compliance with all covenants and restrictions imposed by RAI's indebtedness and RJR Tobacco Company's indebtedness, as the case may be, at June 30, 2017.

For additional information on the RAI Credit Agreement, see note 6 to the RAI Group's unaudited condensed consolidated financial statements in this Offering Memorandum.

Dividends

On February 8, 2017, and May 4, 2017, RAI's board of directors declared a quarterly cash dividend of $0.51 per common share. The dividends were paid on April 3, 2017 and July 3, 2017, to shareholders of record as of March 10, 2017 and June 12, 2017, respectively.

Share Repurchases

During the first six months of 2017, at a cost of $58 million, RAI purchased 940,607 shares of RAI common stock that were forfeited and cancelled with respect to tax liabilities associated with restricted stock units vesting under the RAI Omnibus Plan.

On July 25, 2016, the board of directors of RAI approved the Share Repurchase Program, which authorized the repurchase, from time to time, on or before December 31, 2018, of up to $2 billion of outstanding shares of RAI common stock in open market or privately negotiated transactions. During 2016, in accordance with the RAI Share Repurchase Program, RAI repurchased 1,565,698 shares of RAI common stock for $75 million. Subject to certain exceptions, the merger agreement placed restrictions on RAI's ability to repurchase its common stock. As a result, RAI did not repurchase any shares under the Share Repurchase Program during the first six months of 2017. The Share Repurchase Program terminated effective with the completion of the merger on July 25, 2017.

During 2016, in accordance with the Governance Agreement, at a cost of $93 million, RAI repurchased 1,817,846 shares of RAI common stock in open-market transactions.

In February 2017, RAI and BAT entered into the Letter Agreement, pursuant to which BAT waived the requirement that RAI share repurchases required to be made by RAI pursuant to Amendment No. 3 to the Governance Agreement be made within the time period set forth in that amendment, and permitted RAI to make repurchases in a manner that qualified for the affirmative defense and safe harbor provided by Rules 10b5-1 and 10b-18 under the Exchange Act, respectively. Pursuant to the Letter Agreement, BAT also waived compliance with the general prohibition on repurchases contained in the merger agreement to permit RAI to make these repurchases. During the first six months of 2017, in accordance with the Governance Agreement, at a cost of $81 million, RAI repurchased 1,258,907 shares of RAI common stock in open-market transactions. Subsequent to June 30, 2017, and through July 13, 2017, RAI repurchased and cancelled an additional 113,160 shares of RAI common stock for $7 million in accordance with the Governance Agreement.

Due to RAI's incorporation in North Carolina, which does not recognize treasury shares, the shares repurchased were cancelled at the time of purchase. For additional information, see note 8 to the RAI Group's unaudited condensed consolidated financial statements included in the Offering Memorandum.

Capital Expenditures

RAI's operating subsidiaries recorded cash capital expenditures of $206 million, $174 million and $204 million in 2016, 2015 and 2014, respectively. Of the 2016 amount, $130 million related to RJR Tobacco, $12 million related to Santa Fe and $22 million related to American Snuff. During 2017, capital expenditures, primarily on non-discretionary business requirements, are planned to be $140 million to $160 million for RJR Tobacco, $5 million to $15 million for Santa Fe and $15 million to $25 million for American Snuff.

RAI's operating subsidiaries recorded cash capital expenditures of $66 million and $94 million for the first six months of 2017 and 2016, respectively. RAI's operating subsidiaries expect to spend an additional $165 million to $195 million for capital expenditures during the remainder of 2017, which include upgrading corporate and manufacturing facilities and information management infrastructure. Capital expenditures are funded primarily by cash flows from operations. RAI's operating subsidiaries' capital expenditure programs are expected to continue at a level sufficient to support their strategic and operating needs. There were no material long-term commitments for capital expenditures as of June 30, 2017.

Retirement Benefits

RAI disclosed in its financial statements for the year ended December 31, 2016, that it expects to contribute $111 million to its pension plans in 2017, of which $7 million was contributed during the first six months of 2017.

RAI contributed $335 million to its pension plans and $66 million to its postretirement plans in 2016.

Income Taxes

At December 31, 2016, RAI had a net long-term deferred tax liability of $9.6 billion.

As of December 31, 2016, no valuation allowance was established on deferred tax assets as RAI believes it is more likely than not that the deferred tax assets will be realized through the generation of future taxable income. At December 31, 2015, RAI had recorded a valuation allowance of $8 million to fully offset the deferred tax assets attributable to its Puerto Rico subsidiaries. In 2016, reorganization of the Puerto Rico business in connection with the Lorillard merger and Lorillard Divestiture resulted in the $8 million valuation allowance being reversed.

On December 18, 2015, the Protecting Americans from Tax Hikes (PATH) Act, was signed into law. The PATH Act extends the research credit permanently, retroactive to January 1, 2015. The PATH Act did not significantly impact RAI's annual effective income tax rate in 2015.

On December 19, 2014, the Tax Increase Prevention Act of 2014, referred to as the TIPA, was signed into law. The TIPA retroactively reinstated and extended the Federal Research and Development Tax Credit from January 1, 2014 to December 31, 2014. The impact of the TIPA did not significantly impact RAI's annual effective income tax rate in 2014.

Litigation and Settlements

Reynolds Defendants have been named in a number of tobacco-related legal actions, proceedings or claims seeking damages in amounts ranging into the hundreds of millions or even billions of dollars. For further discussion of specific cases, see note 7 to the RAI Group's unaudited condensed consolidated financial statements in this Offering Memorandum. Unfavorable judgments have been returned in a number of tobacco-related cases and state enforcement actions. As of June 30, 2017, RJR Tobacco Company had paid approximately $179 million since January 1, 2015, related to unfavorable smoking and health litigation judgments.

RAI's unaudited condensed consolidated balance sheet as of June 30, 2017, included in this Offering Memorandum, contains accruals for certain individual *Engle* Progeny cases. Other accruals include an amount for the estimated costs of the corrective communications in the *U.S. Department of Justice* case. For additional information related to these cases and other litigation, see note 7 to the RAI Group's unaudited condensed consolidated financial statements in this Offering Memorandum.

RAI's management continues to conclude that the loss of any particular tobacco-related litigation claim against Reynolds Defendants, or the loss of any particular claim concerning the use of smokeless tobacco products against American Snuff Co., when viewed on an individual case-by-case basis, is not probable or estimable except for certain *Engle* Progeny cases, as described in "— *Litigation Affecting the Cigarette Industry — Overview*" in note 13 to the RAI Group's consolidated financial statements included in this Offering Memorandum. Reynolds Defendants believe that they have valid bases for appeal of adverse verdicts in their pending cases and valid defenses to all actions, and intend to defend all actions vigorously. Nonetheless, the possibility of material losses related to tobacco-related litigation is more than remote. Litigation is subject to many uncertainties, and generally it is not possible to predict the outcome of the litigation pending against Reynolds Defendants, or to reasonably estimate the amount or range of any possible loss, except for the cases noted above. Moreover, notwithstanding the quality of defenses available to Reynolds Defendants in tobacco-related litigation matters, it is possible that RAI's consolidated results of operations, cash flows or financial position could be materially adversely affected by the ultimate outcome of certain pending or future litigation matters or difficulties in obtaining the bonds required to stay execution of judgments on appeal.

In 1998, RJR Tobacco Company, Lorillard Tobacco, B&W, SFNTC and the other major U.S. cigarette manufacturers entered into the MSA with attorneys general representing most U.S. states, territories and possessions. The State Settlement Agreements, of which the MSA is the most wide-reaching, impose a perpetual stream of future payment obligations on RJR Tobacco Company and the other major U.S. cigarette manufacturers and place significant restrictions on their ability to market and sell cigarettes in the future. The State Settlement Agreements have materially adversely affected RJR Tobacco Company's shipment volumes. RAI believes that these settlement obligations may materially adversely affect the results of operations, cash

flows or financial position of RAI and RJR Tobacco Company in future periods. The degree of the adverse impact will depend, among other things, on the rate of decline in U.S. cigarette sales in the premium and value categories, RJR Tobacco Company's share of the domestic premium and value cigarette categories, and the effect of any resulting cost advantage of manufacturers not subject to the State Settlement Agreements.

RJR Tobacco Company and Lorillard Tobacco disputed a total of $6.6 billion and $1.2 billion, respectively, with respect to the NPM Adjustment, for the years 2003 through 2016.

In 2012, RJR Tobacco Company, Lorillard Tobacco, certain other PMs, including SFNTC, and certain settling states entered into a Term Sheet that sets forth terms for resolving accrued and potential NPM Adjustment claims for 2003 through 2012. The Term Sheet also sets forth a restructured NPM Adjustment process to be applied to future volume years, starting with the 2013 volume year. As a result of the Term Sheet settlement, RJR Tobacco Company and SFNTC are to collectively receive more than $1.1 billion in credits, a vast majority of which have been applied to their MSA payments in 2014 through 2017, with the remainder to be applied against their 2018 MSA payment. Credits are recognized when RJR Tobacco Company and SFNTC meet the performance requirements associated with the Term Sheet. Credits recognized in a given year are available to offset the payments made in April of the following year.

In September 2013, the Arbitration Panel ruled six states had not diligently enforced their qualifying statutes in 2003 related to the NPM Adjustment. Two of the six states subsequently joined the Term Sheet in 2014. In 2015, three of the states dropped their challenge of the finding of non-diligence and in 2016, the remaining state dropped its challenge. As such, a portion of the potential recovery from those states was certain and estimable and RJR Tobacco Company recognized the appropriate credit in those years. A final issue regarding the judgment reduction method adopted by the Arbitration Panel was being contested in these four states. In 2016, the U.S. Supreme Court denied RJR Tobacco Company's petition for writ of certiorari against two states, thus eliminating RJR Tobacco Company's remaining recovery from these states. In the first quarter of 2017, the Missouri Supreme Court ruled that the judgment reduction method adopted by the Arbitration Panel should be modified, thus eliminating RJR Tobacco Company's remaining recovery from this state. The final outcome in the remaining state is uncertain.

In October 2015, RJR Tobacco Company, SFNTC and certain other PMs entered into the NY Settlement Agreement to settle certain claims related to the NPM Adjustment. The NY Settlement Agreement resolved NPM Adjustment claims related to payment years from 2004 through 2014, providing RJR Tobacco Company and SFNTC, collectively, with credits of approximately $290 million, plus interest, subject to meeting various performance obligations. These credits will be applied against annual payments under the MSA over a four-year period, which commenced with the April 2016 MSA payment. In addition, the NY Settlement Agreement put in place a new method to determine future adjustments from 2015 forward as to New York.

For additional information relating to proceedings involving NPM Adjustment claims, see *"— Cost of Products Sold*" in note 1 and *"— Litigation Affecting the Cigarette Industry — State Settlement Agreements — Enforcement and Validity; Adjustments*", in note 7 to the RAI Group's unaudited condensed consolidated financial statements in this Offering Memorandum.

For additional information relating to governmental activity, such as taxation and the FDA Tobacco Act, see *"Business of RAI*".

Other Contingencies

For information relating to other contingencies of RAI, R.J. Reynolds Tobacco Holdings, Inc., RJR Tobacco Company, Lorillard Tobacco, American Snuff Co., SFNTC and RJR Vapor, see "— *Other Contingencies*" in note 7 to the RAI Group's unaudited condensed consolidated financial statements included in this Offering Memorandum.

Off-Balance Sheet Arrangements

RAI has no off-balance sheet arrangements that have or are reasonably likely to have a current or future material effect on its financial position, results of operations, liquidity, capital expenditures or capital resources.

BAT UNAUDITED PRO FORMA CONDENSED COMBINED FINANCIAL INFORMATION

The Unaudited Pro Forma Financial Information has been prepared on the basis of the notes set out below to illustrate the effect of the merger and the related financing, excluding the offering of the Notes, as if it had occurred on January 1, 2016 in respect of the unaudited pro forma condensed combined income statements for the year ended December 31, 2016 and for the six months ended June 30, 2017 (referred to in this section of this Offering Memorandum as the Unaudited Pro Forma Income Statements), and as if it had occurred on June 30, 2017 in respect of the unaudited pro forma condensed combined balance sheet (referred to in this section of this Offering Memorandum as the Unaudited Pro Forma Balance Sheet).

The Unaudited Pro Forma Financial Information has been prepared in accordance with Annex II of the Prospectus Directive Regulation and in a manner consistent with the accounting policies adopted by the BAT Group in preparing the audited consolidated financial statements for the year ended December 31, 2016 and the unaudited condensed consolidated financial statements for the six months ended June 30, 2017.

This Unaudited Pro Forma Financial Information has been prepared for illustrative purposes only and, because of its nature, addresses a hypothetical situation and therefore does not represent the BAT Group's or the RAI Group's actual financial position or results. It does not purport to represent what the combined group's financial position actually would have been if the merger and the related financing had been completed on the dates indicated, nor is it indicative of the results that may or may not be expected to be achieved in the future.

The Unaudited Pro Forma Financial Information does not constitute a statutory account within the meaning of section 434 of the UK Companies Act 2006. Prospective investors should read the whole of this Offering Memorandum and not rely solely on the summarised financial information contained in this Unaudited Pro Forma Financial Information. The Pro Forma Financial Information has been prepared in accordance with Annex II of the Prospectus Directive Regulation and not in accordance with the requirements of Regulation S-X under the Securities Act.

BRITISH AMERICAN TOBACCO P.L.C.
UNAUDITED PRO FORMA CONDENSED COMBINED INCOME STATEMENT GIVING EFFECT TO THE MERGER FOR THE YEAR ENDED DECEMBER 31, 2016

	Historical BAT (IFRS)	RAI (IFRS)[3]	Pro forma adjustments			Total pro forma combined
			Financing	Merger		
			(in millions)			
Revenue	£14,751	£ 9,233	£ —	£ (188)	5(c)	£ 23,796
Raw materials and consumables used	(3,777)	(3,407)	—	(352)	5(c)	(7,536)
Changes in inventories of finished goods and work in progress	44	(11)	—	—		33
Employee benefit costs	(2,274)	(694)	—	(14)	5(b)(iv)	(2,982)
Depreciation, amortization and impairment costs	(607)	(91)	—	(52)	5(b)(vii)	(750)
Other operating income	176	3,587	—	(9)	5(c)	3,754
Other operating expenses	(3,658)	(916)	—	(151)	5(a)	(4,725)
Profit from operations	**4,655**	**7,701**[7]	**—**	**(766)**		**11,590**
Net finance (costs)/income	(637)	(648)	(384)	55	4(b), 5(b)(v)	(1,614)
Gain on step acquisition	—	—	—	22,635	5(b)(xi)	22.635
Share of post-tax results of associates and joint ventures	2,227	—	—	(1,880)	5(b)(xi)	347
Profit before taxation	**6,245**	**7,053**	**(384)**	**20,044**		**32,958**
Taxation on ordinary activities	(1,406)	(2,631)	108	(7,704)		(11,633)
Profit for the year	**4,839**	**4,422**	**(276)**	**12,340**		**21,325**
Attributable to:						
Owners of the parent	4,648	4,422	(276)	12,340		21,134
Non-controlling interests	191	—	—	—		191
Earnings per share						
Basic (pence)	250.2					922.1[6]
Diluted (pence)	249.2					918.1
Weighted average shares outstanding, in millions of shares						
Basic	1,858			434		2,292[6]
Diluted	1,865			437		2,302[6]

The accompanying notes are an integral part of this unaudited pro forma condensed combined financial information.

BRITISH AMERICAN TOBACCO P.L.C.
UNAUDITED PRO FORMA CONDENSED COMBINED INCOME STATEMENT GIVING EFFECT TO THE MERGER FOR THE SIX MONTHS ENDED JUNE 30, 2017

	Historical BAT (IFRS)	RAI (IFRS)[3]	Pro forma adjustments			Total pro forma combined
			Financing	Merger		
			(in millions)			
Revenue	£ 7,717	£ 5,008	£ —	£ (87)	5(c)	£12,638
Raw materials and consumables used	(1,881)	(1,919)	—	87	5(c)	(3,713)
Changes in inventories of finished goods and work in progress	(59)	2	—	—		(57)
Employee benefit costs	(1,144)	(393)	—	(14)	5(b)(iv)	(1,551)
Depreciation, amortization and impairment costs	(346)	(50)	—	(26)	5(b)(vii)	(422)
Other operating income	55	—	—	(19)	5(c)	36
Other operating expenses	(1,768)	(435)	—	53	5(a)	(2,150)
Profit from operations	**2,574**	**2,213**[7]	**—**	**(6)**		**4,781**
Net finance (costs)/income	(325)	(245)	(224)	82	4(b), 5(b)(v)	(712)
Share of post-tax results of associates and joint ventures	778	—	—	(543)	5(b)(xi)	235
Profit before taxation	**3,027**	**1,968**	**(224)**	**(467)**		**4,304**
Taxation on ordinary activities	(680)	(664)	63	(47)		(1,328)
Profit for the period	**2,347**	**1,304**	**(161)**	**(514)**		**2,976**
Attributable to:						
Owners of the parent	2,261	1,304	(161)	(514)		2,890
Non-controlling interests	86	—	—	—		86
Earnings per share						
Basic (pence)	121.8					126.1[6]
Diluted (pence)	121.4					125.7
Weighted average shares outstanding, in millions of shares						
Basic	1,858			434		2,292[6]
Diluted	1,863			437		2,300[6]

The accompanying notes are an integral part of this unaudited pro forma condensed combined financial information.

BRITISH AMERICAN TOBACCO P.L.C.
UNAUDITED PRO FORMA CONDENSED COMBINED BALANCE SHEET GIVING EFFECT TO THE MERGER AS OF JUNE 30, 2017

	Historical BAT (IFRS)	RAI (IFRS)[3]	Pro forma adjustments Financing	Merger		Total pro forma combined
			(in millions)			
Assets						
Non-current assets						
Intangible assets	£12,177	£34,791	£ —	£ 73,946	5(b)(vii), 5(b)(x)	£120,914
Property, plant and equipment	3,636	989	—	—		4,625
Investments in associates and joint ventures	9,438	—	—	(7,674)	5(b)(xi)	1,764
Retirement benefit assets	615	—	—	—		615
Deferred tax assets	468	—	—	—		468
Trade and other receivables	758	50	—	—		808
Available-for-sale investments	44	—	—	—		44
Derivative financial instruments	576	—	—	—		576
Total non-current assets	**27,712**	**35,830**	**—**	**66,272**		**129,814**
Current assets						
Inventories	5,177	1,167	—	540	5(b)(vi)	6,884
Income tax receivable	71	—	—	—		71
Trade and other receivables	3,833	329	—	(1)	5(c)	4,161
Available-for-sale investments	26	—	—	—		26
Derivative financial instruments	312	—	—	—		312
Cash and cash equivalents	2,019	1,345	19,075	(18,704)	5(a), 5(b)	3,735
	11,438	2,841	19,075	(18,165)		15,189
Assets classified as held-for-sale	36	—	—	—		36
Total current assets	11,474	2,841	19,075	(18,165)		15,225
Total assets	**39,186**	**38,671**	**19,075**	**48,107**		**145,039**
Equity						
Capital and reserves						
Share capital	507	—	—	108	5(d)	615
Share premium, capital redemption and merger reserves	3,933	13,924	—	9,106	5(d)	26,963
Other reserves	(111)	(17)	—	17	5(d)	(111)
Retained earnings	3,388	3,058	—	19,497	5(d)	25,943
Owners of the parent	**7,717**	**16,965**	**—**	**28,728**		**53,410**
Non-controlling interests	192	—	—	—		192
Total equity	**7,909**	**16,965**	**—**	**28,728**		**53,602**
Liabilities						
Non-current liabilities						
Borrowings	15,085	8,715	7,627	1,191	4(a), 5(b)(v)	32,618
Retirement benefit liabilities	827	1,103	—	—		1,930
Deferred tax liabilities	659	7,498	—	18,229	5(b)(viii)	26,386
Other provisions for liabilities and charges	395	15	—	(15)	5(c)	395
Trade and other payables	1,036	67	—	—		1,103
Derivative financial instruments	79	—	—	—		79
Total non-current liabilities	**18,081**	**17,398**	**7,627**	**19,405**		**62,511**
Current liabilities						
Borrowings	5,822	1,338	11,448	5	4(a), 5(b)(v)	18,613
Income tax payable	622	—	—	—		622
Other provisions for liabilities and charges	330	1,522	—	(30)	5(c)	1,822
Trade and other payables	5,948	1,448	—	(1)	5(c)	7,395
Derivative financial instruments	474	—	—	—		474
Total current liabilities	**13,196**	**4,308**	**11,448**	**(26)**		**28,926**
Total equity and liabilities	**39,186**	**38,671**	**19,075**	**48,107**		**145,039**

The accompanying notes are an integral part of this unaudited pro forma condensed combined financial information.

NOTES TO UNAUDITED PRO FORMA CONDENSED COMBINED FINANCIAL INFORMATION

Note 1. Basis of presentation

The Unaudited Pro Forma Financial Information set forth herein is based upon the BAT Group's consolidated financial statements and unaudited condensed consolidated financial statements and the RAI Group's consolidated financial statements and unaudited condensed consolidated financial statements and has been prepared to illustrate the effects of the merger, including the financing structure established to fund the merger, as if it had occurred on January 1, 2016 in respect of the Unaudited Pro Forma Income Statements, and as if it had occurred on June 30, 2017 in respect of the Unaudited Pro Forma Balance Sheet. The Unaudited Pro Forma Financial Information is presented for informational purposes only and is not necessarily indicative of the combined group's financial position or results of operations that would have been realized had the merger occurred as of the dates indicated, nor is it meant to be indicative of any anticipated combined financial position or future results of operations that the combined group will experience after the completion of the merger.

The merger will be accounted for as a business combination using the acquisition method of accounting in accordance with IFRS under IFRS 3, which requires that one of the two companies in the merger be designated as the acquirer for accounting purposes based on the evidence available. BAT will be treated as the accounting acquirer, and accordingly, the RAI assets acquired and liabilities assumed have been adjusted based on preliminary estimates of fair value. Any excess of the purchase price over the fair value of identified assets acquired and liabilities assumed will be recognized as goodwill. The detailed valuation studies necessary to arrive at required estimates of fair values of the assets acquired and liabilities assumed from RAI in the merger have not been completed. Significant assets and liabilities that are subject to preparation and completion of valuation studies to determine appropriate fair value adjustments include property, plant and equipment, identifiable intangible assets and debt obligations. Changes to the fair values of these assets and liabilities will also result in changes to goodwill and deferred income taxes. The actual fair values will be determined at a subsequent date and may vary materially from these preliminary estimates.

Pro forma adjustments reflected in the Unaudited Pro Forma Financial Information are based on items that are factually supportable and directly attributable to the merger. The Unaudited Pro Forma Financial Information does not reflect the cost of any integration activities or benefits from the merger, including potential synergies that may be generated in future periods.

The estimated income tax impacts of the pre-tax adjustments that are reflected in the Unaudited Pro Forma Financial Information are calculated using an estimated blended statutory rate, which is based on preliminary assumptions related to the jurisdictions in which the income (expense) adjustments will be recorded. The estimated blended statutory rate and the effective tax rate of the combined group could be significantly different depending on the post-transaction activities and geographical mix of profit before taxes.

RAI's presentation currency is U.S. dollars, while BAT's presentation currency is the pound sterling. BAT has used exchange rates of £0.73801/$1, and £0.79385/$1 being the mid-market weighted average rates for the year ended December 31, 2016 and six months ended June 30, 2017, respectively, and the spot rate of £0.76985/$1 and £0.76517/$1 at June 30, 2017 and July 25, 2017, respectively, to translate the RAI Group's consolidated financial statements and all associated financing and merger adjustments. These exchange rates may differ from future exchange rates, which would have an impact on the Unaudited Pro Forma Financial Information.

Note 2. BAT's financial information

BAT's financial information for the year ended December 31, 2016 and as at and for the six months ended June 30, 2017 has been extracted without material adjustment from BAT's published financial information.

Note 3. Supplementary Information: Illustrative adjustments to the RAI Group's primary U.S. GAAP consolidated financial statements

The financial statements below illustrate the impact of adjustments made to the RAI Group's consolidated financial statements in order to present them on a basis consistent with BAT's accounting policies under IFRS. These adjustments reflect BAT's best estimates based upon the information currently available to BAT, and could be subject to change once more detailed information is obtained.

Note 3. Supplementary Information: Illustrative adjustments to the RAI Group's primary U.S. GAAP consolidated financial statements (Continued)

Unaudited Adjusted RAI Income Statement
For the Year ended December 31, 2016

	Historical RAI, USD (U.S. GAAP)	Reclassifications and U.S. GAAP to IFRS adjustments				RAI, USD (IFRS)	RAI, GBP (IFRS)
		Reclassifications (3a)	LIFO inventories (3b)	Pensions (3c, 3d, 3e)	Revenue recognition (3f)		
Net sales[(1)]	$12,277	$(12,277)	$ —	$ —	$—	$ —	£ —
Net sales, related party	226	(226)	—	—	—	—	—
Revenue	—	12,503	—	—	8	12,511	9,233
Raw materials and consumables used	—	(4,594)	(15)	—	(8)	(4,617)	(3,407)
Changes in inventories of finished goods and work in progress	—	(15)	—	—	—	(15)	(11)
Cost of products sold[(1)]	(4,841)	4,841	—	—	—	—	
Employee benefit costs	—	(821)	—	(119)	—	(940)	(694)
Selling, general and administrative expenses	(1,931)	1,931	—	—	—	—	—
Gain on divestiture	4,861	(4,861)	—	—	—	—	—
Depreciation, amortization and impairment costs	—	(123)	—	—	—	(123)	(91)
Amortization expense	(23)	23	—	—	—	—	
Other operating income	—	4,861	—	—	—	4,861	3,587
Other operating expenses	—	(1,242)	—	—	—	(1,242)	(916)
Profit from operations	**10,569**	**—**	**(15)**	**(119)**	**—**	**10,435**	**7,701**
Interest and debt expense	(626)	626	—	—	—	—	—
Interest income	8	(8)	—	—	—	—	—
Other income/expenses, net	(260)	260	—	—	—	—	—
Net finance (costs)/income	—	(878)	—	—	—	(878)	(648)
Share of post-tax results of associates and joint ventures	—	—	—	—	—	—	—
Profit before taxation	**9,691**	**—**	**(15)**	**(119)**	**—**	**9,557**	**7,053**
Provision for income taxes	(3,618)	3,618	—	—	—	—	—
Taxation on ordinary activities	—	(3,618)	6	47	—	(3,565)	(2,631)
Profit for the year	**6,073**	**—**	**(9)**	**(72)**	**—**	**5,992**	**4,422**
Attributable to:							
Owners of the parent	6,073	—	(9)	(72)	—	5,992	4,422
Non-controlling interests	—	—	—	—	—	—	—

(1) Excludes duty, excise and other taxes of $4,343 million (£3,205 million).

Note 3. Supplementary Information: Illustrative adjustments to the RAI Group's primary U.S. GAAP consolidated financial statements (Continued)

Unaudited Adjusted RAI Income Statement
For the Six Months ended June 30, 2017

	Historical RAI, USD (U.S. GAAP)	Reclassifications and U.S. GAAP to IFRS adjustments				RAI, USD (IFRS)	RAI, GBP (IFRS)
		Reclassifications (3a)	LIFO inventories (3b)	Pensions (3c, 3d, 3e)	Revenue recognition (3f)		
Net sales[(1)]	$ 6,201	$(6,201)	$—	$ —	$ —	$ —	£ —
Net sales, related party	66	(66)	—	—	—	—	—
Revenue	—	6,267	—	—	41	6,308	5,008
Raw materials and consumables used	—	(2,380)	4	—	(41)	(2,417)	(1,919)
Changes in inventories of finished goods and work in progress	—	2	—	—	—	2	2
Cost of products sold[(1)]	(2,477)	2,477	—	—	—	—	—
Employee benefit costs	—	(396)	—	(99)	—	(495)	(393)
Selling, general and administrative expenses	(896)	896	—	—	—	—	—
Gain on divestiture	—	—	—	—	—	—	—
Depreciation, amortization and impairment costs	—	(63)	—	—	—	(63)	(50)
Amortization expense	(12)	12	—	—	—	—	—
Other operating income	—	—	—	—	—	—	—
Other operating expenses	—	(548)	—	—	—	(548)	(435)
Profit from operations	**2,882**	**—**	**4**	**(99)**	**—**	**2,787**	**2,213**
Interest and debt expense	(299)	299	—	—	—	—	—
Interest income	5	(5)	—	—	—	—	—
Other income/expenses, net	(15)	15	—	—	—	—	—
Net finance (costs)/income	—	(309)	—	—	—	(309)	(245)
Share of post-tax results of associates and joint ventures	—	—	—	—	—	—	—
Profit before taxation	**2,573**	**—**	**4**	**(99)**	**—**	**2,478**	**1,968**
Provision for income taxes	(874)	874	—	—	—	—	—
Taxation on ordinary activities	—	(874)	(2)	40	—	(836)	(664)
Profit for the period	**1,699**	**—**	**2**	**(59)**	**—**	**1,642**	**1,304**
Attributable to:							
Owners of the parent	1,699	—	2	(59)	—	1,642	1,304
Non-controlling interests	—	—	—	—	—	—	—

(1) Excludes excise taxes of $2,065 million (£1,639 million).

Note 3. Supplementary Information: Illustrative adjustments to the RAI Group's primary U.S. GAAP consolidated financial statements (Continued)

Unaudited Adjusted RAI Balance Sheet
As of June 30, 2017

	Historical RAI, USD (U.S. GAAP)	Reclassifications and U.S. GAAP to IFRS adjustments: Reclassifications (3a)	LIFO inventories (3b)	Pensions (3c, 3d, 3e)	Revenue recognition (3f)	RAI, USD (IFRS)	RAI, GBP (IFRS)
	(in millions)						
Assets							
Non-current assets							
Goodwill	$15,992	$(15,992)	$ —	$ —	$ —	$ —	£ —
Trademarks and other intangible assets, net of accumulated amortization	29,432	(29,432)	—	—	—	—	—
Intangible assets	—	45,469	—	—	—	45,469	34,791
Property, plant and equipment, net	1,338	(1,338)	—	—	—	—	—
Property, plant and equipment	—	1,293	—	—	—	1,293	989
Investments in associates and joint ventures	—	—	—	—	—	—	—
Retirement benefit assets	—	—	—	—	—	—	—
Deferred tax assets	—	—	—	—	—	—	—
Other assets and deferred charges	65	(65)	—	—	—	—	—
Trade and other receivables	—	65	—	—	—	65	50
Available-for-sale investments	—	—	—	—	—	—	—
Derivative financial instruments	—	—	—	—	—	—	—
Total non-current assets	**46,827**	**—**	**—**	**—**	**—**	**46,827**	**35,830**
Current assets							
Inventories	1,448	—	143	—	(66)	1,525	1,167
Income tax receivable	—	—	—	—	—	—	—
Accounts receivable	123	(123)	—	—	—	—	—
Accounts receivable, related party	1	(1)	—	—	—	—	—
Other receivables	11	(11)	—	—	—	—	—
Other current assets	295	(295)	—	—	—	—	—
Trade and other receivables	—	430	—	—	—	430	329
Available-for-sale investments	—	—	—	—	—	—	—
Derivative financial instruments	—	—	—	—	—	—	—
Deferred income taxes, net	—	—	—	—	—	—	—
Cash and cash equivalents	1,758	—	—	—	—	1,758	1,345
Assets classified as held-for-sale	—	—	—	—	—	—	—
Total current assets	**3,636**	**—**	**143**	**—**	**(66)**	**3,713**	**2,841**
Total assets	**50,463**	**—**	**143**	**—**	**(66)**	**50,540**	**38,671**
Equity							
Capital and reserves							
Share capital	$ —	$ —	$ —	$ —	$ —	$ —	£ —
Paid-in capital	18,197	(18,197)	—	—	—	—	—
Share premium, capital redemption and merger reserves	—	18,197	—	—	—	18,197	13,924
Accumulated other comprehensive loss	(291)	291	—	—	—	—	—
Other reserves	—	(291)	—	268	—	(23)	(17)
Retained earnings	3,980	—	87	(71)	—	3,996	3,058
Owners of the parent	**21,886**	**—**	**87**	**197**	**—**	**22,170**	**16,965**
Non-controlling interests	—	—	—	—	—	—	—
Total equity	**21,886**	**—**	**87**	**197**	**—**	**22,170**	**16,965**

Note 3. Supplementary Information: Illustrative adjustments to the RAI Group's primary U.S. GAAP consolidated financial statements (Continued)

	Historical RAI, USD (U.S. GAAP)	Reclassifications and U.S. GAAP to IFRS adjustments				RAI, USD (IFRS)	RAI, GBP (IFRS)
		Reclassifications (3a)	LIFO inventories (3b)	Pensions (3c, 3d, 3e)	Revenue recognition (3f)		
Liabilities							
Non-current liabilities							
Long-term debt (less current maturities)	11,390	(11,390)	—	—	—	—	—
Borrowings	—	11,390	—	—	—	11,390	8,715
Long-term retirement benefits (less current portion)	1,768	(1,768)	—	—	—	—	—
Retirement benefit liabilities	—	1,768	—	(326)	—	1,442	1,103
Long-term deferred income taxes, net	9,614	(9,614)	—	—	—	—	—
Deferred tax liabilities	—	9,614	56	129	—	9,799	7,498
Long-term deferred revenue, related party	19	(19)	—	—	—	—	—
Other noncurrent liabilities	244	(244)	—	—	—	—	—
Other provisions for liabilities and charges	—	19	—	—	—	19	15
Trade and other payables	—	88	—	—	—	88	67
Derivative financial instruments	—	—	—	—	—	—	—
Total non-current liabilities	**23,035**	**(156)**	**56**	**(197)**	**—**	**22,738**	**17,398**
Current liabilities							
Current maturities of long-term debt	1,748	(1,748)	—	—	—	—	—
Borrowings	—	1,748	—	—	—	1,748	1,338
Income tax payable	—	—	—	—	—	—	—
Tobacco settlement accruals	1,833	(1,833)	—	—	—	—	—
Other current liabilities	935	(935)	—	—	—	—	—
Other provisions for liabilities and charges	—	1,989	—	—	—	1,989	1,522
Accounts payable	193	(193)	—	—	—	—	—
Due to related party	—	—	—	—	—	—	—
Deferred revenue, related party	106	(106)	—	—	—	—	—
Dividends payable on common stock	727	(727)	—	—	—	—	—
Trade and other payables	—	1,961	—	—	(66)	1,895	1,448
Derivative financial instruments	—	—	—	—	—	—	—
Total current liabilities	**5,542**	**156**	**—**	**—**	**(66)**	**5,632**	**4,308**
Total equity and liabilities	**50,463**	**—**	**143**	**—**	**(66)**	**50,540**	**38,671**

(a) The classification of certain items presented by RAI under U.S. GAAP has been modified in order to align with the presentation used by BAT under IFRS.

Modification to RAI's historical income statement presentation include:

- Presentation of net sales and net sales, related party together within revenue;
- Separate presentation of components of cost of products sold into raw materials and consumables used, changes in inventories of finished goods and work in progress, employee benefit costs and depreciation, amortization and impairment costs;
- Separate presentation of components of selling, general and administrative expenses into employee benefit costs, depreciation, amortization and impairment costs and other operating expenses;

Note 3. Supplementary Information: Illustrative adjustments to the RAI Group's primary U.S. GAAP consolidated financial statements (Continued)

- Presentation of gain on divestiture in other operating income;
- Presentation of amortization expense and asset impairment charges within depreciation, amortization and impairment costs; and
- Presentation of interest and debt expense, interest income and other income/expenses (net) within net finance (costs)/income.

Modification to RAI's historical balance sheet presentation include:

- Presentation of goodwill within intangible assets;
- Presentation of trademarks and other intangible assets, net of accumulated amortization, within intangible assets;
- Presentation of other assets and deferred charges, other receivables, accounts receivable, accounts receivable (related party) and other current assets together within trade and other receivables (current and non-current as applicable);
- Presentation of tobacco settlement accruals and liabilities for uncertain tax benefits (non-current) together within other provisions for liabilities and charges (current); and
- Presentation of accounts payable, other current liabilities, deferred revenue related party and dividends payable on common stock together within trade and other payables.

(b) Under U.S. GAAP, RAI has historically accounted for the cost of tobacco inventories principally under the last-in, first-out, or LIFO method. The LIFO method of accounting for inventory is not allowable under IFRS, and BAT accounts for these inventories based on the weighted average cost method. Consequently, RAI's LIFO reserve of $143 million as of June 30, 2017 and the related impact to deferred tax liabilities of $56 million have been reversed in the Unaudited Pro Forma Balance Sheet. The associated benefit/(charge) to raw materials and consumables used of $15 million and $(4) million for the year ended December 31, 2016 and six months ended June 30, 2017, respectively, have been reversed in the Unaudited Pro Forma Income Statements with a related impact to provision for income taxes of $6 million and $(2) million, respectively. The net impact to retained earnings at June 30, 2017 is $87 million.

(c) Under U.S. GAAP, the expected return on pension plan assets is used to calculate the return component of net periodic benefit costs, with the difference between the actual and expected rate of return recognized as a component of actuarial gains and losses within accumulated other comprehensive income with subsequent recognition in the income statement to the extent the net gains or losses are in excess of the corridor. Under IFRS as applied by BAT, net interest cost on defined benefit plans, a component of defined benefit costs, is calculated by applying the discount rate assumption to the net defined benefit liability. The difference between actual return on plan assets and the component of net interest derived from plan assets is recognized in accumulated other comprehensive income as a component of remeasurement gains and losses. IFRS does not permit recognition of remeasurement gains and losses in profit in current or future periods. As a result, employee benefit costs for the year ended December 31, 2016 and six months ended June 30, 2017 reflect an increase of $80 million and $82 million, respectively. For 2016, this adjustment comprises a combination of a debit to net periodic benefit cost of $125 million and the reversal of RAI's "mark to market" adjustment to record actuarial gains in excess of corridor amounting to $45 million in 2016 with an impact to taxation on ordinary activities of $32 million. For the six months ended June 30, 2017, the adjustment consists of a debit to net periodic benefit cost of $82 million with an impact to taxation on ordinary activities of $33 million.

(d) Under U.S. GAAP, prior service costs are recognized in accumulated other comprehensive income at the date of the adoption of the plan amendment and then amortized into income as employee benefit costs. Under IFRS, prior service costs cannot be spread over a future service period but rather are recognized immediately. Accordingly, employee benefit costs for the year ended December 31, 2016 and six months ended June 30, 2017 reflect an increase of $39 million and $17 million, respectively, to reverse prior service cost gains, which were amortized to income in the period as employee benefit costs. The related impact to taxation on ordinary activities is $15 million and $7 million. Additionally, accumulated prior service cost gains of $71 million (net of tax) recorded in accumulated other comprehensive income relating to periods prior to and including the six months ended June 30, 2017 have been reclassified to retained earnings.

(e) In accordance with U.S. GAAP, RAI measures its retirement benefit plan assets and obligations as of its fiscal year-end balance sheet date. Under IFRS, BAT remeasures its retirement benefit obligations and plan

Note 3. Supplementary Information: Illustrative adjustments to the RAI Group's primary U.S. GAAP consolidated financial statements (Continued)

assets at each interim period. Remeasurement of RAI's retirement benefit plan assets and obligations as at June 30, 2017 results in a decrease of RAI's total retirement benefit liability of $326 million with a corresponding increase in deferred tax liability of $129 million. The net impact to equity is $197 million, and there is no impact to the Unaudited Pro Forma Income Statement for the six months ended June 30, 2017.

(f) RAI has deferred certain related party sales transactions for which the U.S. GAAP revenue recognition criteria have not been met. This is primarily because shipment of the related inventory has not occurred. Under IFRS as applied by BAT, these transactions are determined to meet the revenue recognition criteria requiring the transfer of risks and rewards to the customer prior to period end and have been recognized accordingly.

Note 4. Pro forma adjustments related to financing

(a) Sources of funding

A $25.0 billion acquisition facility was entered into by members of the BAT Group with a syndicate of banks to provide financing for the merger. The acquisition facility consists of four credit facilities:

(1) a $15.0 billion bridge facility, referred to as Facility A, which, subject to two six-month extension options exercisable at BAT's option, matures on July 17, 2018;

(2) a $5.0 billion bridge facility, referred to as Facility B, which, subject to two six-month extension options exercisable at BAT's option, matures on July 17, 2019;

(3) a $2.5 billion term loan, referred to as Facility C, which matures on July 17, 2020; and

(4) a $2.5 billion term loan, referred to as Facility D, which matures on January 16, 2022.

The acquisition facility bears interest at a rate per annum equal to LIBOR (or in the case of euro-denominated borrowings, EURIBOR) plus the applicable margin, which, based on BAT's current ratings as assessed by Standard & Poor's Ratings Services and Moody's Investors Service, are as follows: (1) Facility A: between 0.5125% and 1.5625% per annum based on the applicable borrowing period; (2) Facility B: between 0.5625% and 2.2125% per annum based on the applicable borrowing period; (3) Facility C: 0.70% per annum; and (4) Facility D: 0.80% per annum. These rates are subject to adjustments in accordance with the terms of the acquisition facility based on the applicable credit rating assigned to the BAT Group. If the LIBOR or EURIBOR rate is below zero, such rate shall be deemed to be zero.

BAT separately entered into a £5.68 billion revolving credit facility which has two revolving facilities to be used for the general corporate purposes of the BAT Group: (1) a £2.84 billion 364-day facility, which is a new facility, referred to as Revolving Facility A; and (2) a £2.84 billion facility maturing on May 29, 2021, which effectively replaced BAT's £3 billion revolving credit facility entered into on May 29, 2014.

This new revolving credit facility was not drawn on with respect to the merger and accordingly this facility has been excluded from the debt financing adjustments below.

The financing adjustments to cash and debt reflected in the Unaudited Pro Forma Balance Sheet are as follows:

	Financing adjustments
	(in £ millions)
Proceeds from Facility A	11,478
Proceeds from Facility B	3,826
Proceeds from Facility C	1,913
Proceeds from Facility D	1,913
Total sources of funding	**19,130**
Debt issuance costs	(55)[1]
Total sources of funding, net	**19,075**
Presented as:	
Current portion of debt adjustment	11,448
Non-current portion of debt adjustment	7,627

(1) In relation to Facility A, Facility B, Facility C and Facility D, debt issuance costs are assumed to be £29 million, £12 million, £6 million and £8 million, respectively.

(b) Financing charges

As detailed below, net financing costs consist of interest expense and facility fees.

Interest expense in the Unaudited Pro Forma Income Statements has been adjusted as follows based on the expected sources of funding described above:

For the year ended December 31, 2016

	Assumed principal	Interest rate	Interest expense
		(in £ millions)	
Facility A	11,478	1.79%	198
Facility B	3,826	1.84%	68
Facility C	1,913	2.02%	37
Facility D	1,913	2.12%	39
Total	**19,130**		**342**
Debt issuance cost amortization:			
Facility A			28
Facility B			6
Facility C			2
Facility D			1
Total interest expense adjustment			**379**

For the six months ended June 30, 2017

	Assumed principal	Interest rate	Interest expense
		(in £ millions)	
Facility A	11,478	2.20%	131
Facility B	3,826	2.25%	45
Facility C	1,913	2.02%	20
Facility D	1,913	2.12%	21
Total	**19,130**		**217**
Debt issuance cost amortization:			
Facility A			—
Facility B			3
Facility C			1
Facility D			1
Total interest expense adjustment			**222**

As of July 25, 2017, the BAT Group's credit rating was BBB+ and Baa2 with Standard & Poor's Ratings Services and Moody's Investors Service, respectively. For purposes of the interest expense calculation, BAT has assumed an interest rate based on the opening margin within the applicable margin matrix for each facility for an average credit rating of BBB+/Baa2 with increases at each period specified in the acquisition facility agreement. BAT has also considered the variability of the applicable margin based on the BAT Group's credit rating in accordance with each applicable margin matrix, which each include a maximum rating of "A-/A3" to a minimum rating of "BBB-/Baa3 or below". A change in the credit rating to BBB-/Baa3 or lower (or no rating) from BBB+/Baa2 would increase the interest expense for the Unaudited Pro Forma Income Statements by approximately £33 million for the year ended December 31, 2016, and by approximately £17 million for the six months ended June 30, 2017. A change in the credit rating of the BAT Group to A-/A3 from BBB+/Baa2 would decrease the interest expense for the Unaudited Pro Forma Income Statements by approximately £11 million for the year ended December 31, 2016, and by approximately £6 million for the six months ended June 30, 2017.

For the purposes of calculating the above interest expense, a three-month U.S. dollar LIBOR rate of 1.32% as of July 25, 2017 has been assumed, which may differ from the rates in place when actually utilizing the facilities. A hypothetical change in interest rates of 0.125% would increase or decrease total interest expense for the Unaudited Pro Forma Income Statements by approximately £23 million for the year ended December 31, 2016, and by approximately £12 million for the six months ended June 30, 2017.

In addition to incremental interest charges, BAT has also recorded a pro forma adjustment for debt issuance cost amortization for each facility, which will be deferred and amortized over the duration of the borrowings in accordance with IAS 39, Financial Instruments: Recognition and Measurement. This adjustment will have a continuing impact on the combined group for the remaining life of the borrowings.

For the purposes of the Unaudited Pro Forma Financial Information, BAT has assumed that the new borrowings under the facilities will remain unchanged during the fiscal year ended December 31, 2016 and the six months ended June 30, 2017.

BAT may continue to seek alternatives to refinance the facilities in order to achieve its long term capital structure target. For the purposes of this Unaudited Pro Forma Financial Information, BAT has assumed that no such financings, refinancings or repayments have occurred.

For the year ended December 31, 2016, the adjustment to net finance (costs)/income in the Unaudited Pro Forma Income Statement of £(384) million comprises net finance costs of £379 million relating to the Acquisition Facility described in Note 4(a) above, and £5 million relating to facility fees to be incurred with respect to Revolving Facility A. For the six months ended June 30, 2017, the adjustment to net finance (costs)/income in the Unaudited Pro Forma Income Statement of £(224) million comprises net finance costs of £222 million relating to the Acquisition Facility described in Note 4(a) above, and £2 million relating to facility fees to be incurred with respect to Revolving Facility A. These facility fees will not have a continuing impact on the combined group.

The tax benefit on the total financing charges was £108 million for the year ended December 31, 2016 and £63 million for the six months ended June 30, 2017.

Note 5. Pro forma adjustments related to the merger

(a) Transaction and related costs

It has been estimated that total transaction and related costs of £239 million (£188 million after tax) will be incurred collectively by BAT and RAI in connection with the merger, which include advisory, legal, audit, valuation and other professional fees. BAT and RAI each incurred £11 million and £4 million of transaction and related costs, respectively (£9 million and £3 million after tax, respectively) in the year ended December 31, 2016, and £35 million and £18 million (£28 million and £14 million after tax, respectively) in the six months ended June 30, 2017. As a result, an adjustment of £224 million has been presented in the Unaudited Pro Forma Income Statement for the year ended December 31, 2016 as an other operating expense along with an associated tax impact of £48 million. These one-off costs will not have a continuing impact on the results of the combined group.

An adjustment of £125 million has been presented in the Unaudited Pro Forma Balance Sheet as a reduction in cash and cash equivalents, which comprises the following:

- Total transaction costs estimated to be incurred by BAT in conjunction with the merger are £139 million (£112 million net of tax). An adjustment of £62 million has been presented in the Unaudited Pro Forma Balance Sheet as a reduction to cash and a corresponding reduction to retained earnings to represent the estimated total after tax transaction and related costs, net of those that have already been incurred by BAT.
- Total transaction costs estimated by RAI in conjunction with the merger are £100 million (£79 million net of tax). An adjustment of £63 million has been presented in the Unaudited Pro Forma Balance Sheet as a reduction to cash and a corresponding reduction to retained earnings to represent the estimated total after tax transaction and related costs, net of those that have already been incurred by RAI.

(b) Preliminary purchase consideration and allocation

The merger will be accounted for as a business combination using the acquisition method of accounting in accordance with IFRS. Under this method, the RAI assets acquired and liabilities assumed have been recorded based on preliminary estimates of fair value. In accordance with IFRS, BAT measures fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The final fair values below are preliminary and may vary materially from the final purchase price allocation fair values.

Preliminary Purchase Price

The estimated purchase consideration is calculated as follows:

	(in £ millions, except per share data and share price)
RAI shares outstanding as of July 25, 2017, other than those held by BAT	824,757,460(i)
Exchange ratio	0.5260
Total BAT ordinary shares issued to RAI shareholders, other than BAT	433,822,424
BAT ADS price as at transaction close	£ 52.99
Total equity consideration	22,988(ii)
Cash consideration	18,579(iii)
Additional consideration for stock compensation	150(iv)
Total purchase consideration	**41,717**
Add: Fair market value of total debt assumed	11,249(v)
Less: Total cash acquired	(1,345)
Purchase consideration including debt assumed and net of cash acquired	51,621
Fair value of 42.2% BAT equity interest already held	30,309(xi)
Total purchase consideration and fair value of BAT equity interest already held	**72,026**

(i) Excluding the total number of shares of RAI common stock as at July 25, 2017 issuable under outstanding RAI equity awards settled for BAT ADSs in connection with the merger.

(ii) The total equity consideration for each share of RAI common stock was estimated using the price of BAT ADSs on the NYSE MKT as at transaction close after giving effect to the BAT ADS ratio change converted to pounds sterling using the exchange rate as at transaction close of £0.76517/$1, and the number of shares outstanding not held by the BAT Group as at transaction close.

No fractional BAT ADSs were issued in the merger, and RAI shareholders will receive cash in lieu of fractional BAT ADSs. The amount of cash disbursed for the fractional BAT ADSs from the sale of such BAT ADSs is not material.

(iii) The total cash consideration was calculated using the shares of RAI common stock outstanding as at transaction close, other than those held by the BAT Group, and the $29.44 due to RAI shareholders for each share of RAI common stock other than those held by the BAT Group, converted to pounds sterling using the exchange rate as at transaction close of £0.76517/$1.

(iv) At completion of the merger, each cash-out RSU was canceled and converted into the right to receive merger consideration and cash for any accrued dividend equivalent right in respect of such cash-out RSU, in each case less any required withholding taxes.

Rollover RSUs were converted into a restricted stock unit of BAT with respect to a target number of BAT ADS equal to the product of (1) the target number of shares of RAI common stock subject to the rollover RSUs immediately prior to the completion of the merger and (2) the RSU exchange ratio subject to adjustment as provided in the merger agreement to prevent dilution. The portion of the award that has been included as part of the consideration has been determined by multiplying the fair value of the award as at transaction close by the portion of the requisite service period that elapsed prior to the merger divided by the total service period.

The estimated portion of the award attributable to post-combination services resulted in additional compensation expense of £14 million in employee benefit costs for the year ended December 31, 2016 and £9 million for the six months ended June 30, 2017. This adjustment has been tax affected using a statutory tax rate of 39.5% resulting in a net adjustment of £9 million for the year ended December 31, 2016 and £5 million for the six months ended June 30, 2017.

Prior to the merger, RAI had an equity incentive award plan for directors of RAI which provided grants of RAI DSUs. These units were settled in either cash or shares of RAI common stock on the later of January 2 of a specified year or January 2 following a director's last year of service on the board. As these units could be cash settled they were accrued and recorded in other current and other non-current liabilities on the historical RAI balance sheet. Upon completion of the merger, these RAI DSUs were converted into the right to receive merger consideration, or another form of payment (i.e., cash or BAT ADSs) that was equal in value to the merger consideration, less any required withholding taxes, for each share of RAI common stock subject to such RAI DSU.

(v) The fair value of RAI's debt as at transaction close was £11.2 billion, or a net increase of £1,196 million compared to the carrying value of £10.1 billion. An adjustment of £5 million and £1,191 million to the current and non-current portion of long-term debt, respectively, is recorded to adjust the carrying value to reflect the fair value of debt assumed, with a net increase in deferred tax asset of £472 million.

As a result of the step-up in fair value of existing RAI debt, interest expense is reduced by £49 million in the year ended December 31, 2016, with an associated £22 million increase in income tax expense. Interest expense is further reduced to reflect the elimination of amortization related to RAI's previously deferred debt issuance costs of £6 million for the year ended December 31, 2016 (£2 million net of tax). The total adjustment to interest expense is therefore £55 million (£24 million net of tax) for the year ended December 31, 2017.

As a result of the step-up in fair value of existing RAI debt, interest expense is reduced by £79 million in the six months ended June 30, 2017, with an associated £32 million increase in income tax expense. Interest expense is further reduced to reflect the elimination of amortization related to RAI's previously deferred debt issuance costs of £3 million for the six months ended June 30, 2017 (£1 million net of tax). The total adjustment to interest expense is therefore £82 million (£50 million net of tax) for the six months ended June 30, 2017.

These adjustments will have a continuing impact on the combined group for the remaining life of the RAI Group's debt.

Preliminary Allocation of Purchase Price

The preliminary allocation of purchase consideration to estimated fair value of acquired assets and liabilities is as follows:

	(in £ millions)
Estimated fair values of assets acquired and liabilities assumed	
Inventory	1,707(vi)
Identifiable intangible assets	68,078(vii)
Borrowings	(11,249)(v)
Deferred taxes, net	(25,727)(viii)
Other net liabilities assumed	(1,442)(ix)
Goodwill	40,659(x)
Total allocation	**72,026**

(vi) BAT's pro forma fair value adjustment to inventory of £540 million is based on RAI's inventory as of June 30, 2017 with a carrying value of £1.2 billion. As BAT sells the acquired inventory, its cost of sales will reflect the increased valuation of RAI's inventory, which will temporarily reduce BAT's gross margins until such inventory is sold. Based on the assumption that those inventories will be sold within the first twelve months following the merger, an adjustment of £540 million (£327 million net of tax) has been presented in 'raw materials and consumables used' within the Unaudited Pro Forma Income Statement for the year ended December 31, 2016. This is considered a non-recurring adjustment.

(vii) The estimated fair value of RAI's intangible assets is estimated to be £68.1 billion, or a net increase of £45.5 billion compared to a carrying value of £22.6 billion at June 30, 2017. The primary intangible assets include brands and trademarks, for which the fair value estimates of identifiable intangible assets have been determined based on publicly available benchmark data using the income approach. The assumptions used by BAT to arrive at the estimated fair value of the identifiable intangible assets have been derived primarily from publicly available information, including market transactions of varying degrees of comparability. However, a detailed analysis has not been completed and actual results may differ materially from these estimates.

The RAI Group holds a number of internally developed patents and technologies, particularly in relation to its next generation products business. BAT does not have sufficient information at this time nor has it identified any appropriately comparable market transactions to perform any valuation analysis. These factors could result in differences between fair value and net book value. Accordingly, for the purposes of this Unaudited Pro Forma Financial Information, BAT believes, to the best of its knowledge that the current RAI carrying values represent the best estimate of fair value. This estimate is preliminary and subject to change.

The fair value and weighted average estimated useful life of identifiable trademarks and similar intangible assets are estimated as follows:

For the year ended December 31, 2016

	Fair value	Weighted-average estimated useful life	Amortization
	(in £ millions)	(in years)	(in £ millions)
Trademarks and similar intangibles	67,379	Indefinite	—
Trademarks and similar intangibles	529	20	26
Trademarks and similar intangibles	135	5-15	26
Total acquired trademarks and similar intangible assets	68,043		52

For the six months ended June 30, 2017

	Fair value	Weighted-average estimated useful life	Amortization
	(in £ millions)	(in years)	(in £ millions)
Trademarks and similar intangibles	67,379	Indefinite	—
Trademarks and similar intangibles	529	20	13
Trademarks and similar intangibles	135	5-15	13
Total acquired trademarks and similar intangible assets	68,043		26
Less: RAI's historical net book value of trademarks and similar intangible assets	(22,520)		
Adjustment to intangible assets, net	45,523		

Based on the estimated respective fair values of identified trademarks and similar intangible assets and the weighted average estimated useful lives, an increase to amortization expense of £52 million for the year ended December 31, 2016, and £26 million for the six months ended June 30, 2017 have been included in the Unaudited Pro Forma Income Statements. The related estimated net decrease to income tax expense in the Unaudited Pro Forma Income Statements is £21 million and £11 million, respectively. This adjustment will recur for the life of the underlying assets.

(viii) A net adjustment of £18.2 billion to non-current deferred tax liabilities has been recorded on the net fair value step-up on RAI's assets acquired and liabilities assumed. This adjustment includes the recognition of a deferred tax liability of £26.9 billion relating to the estimated gross fair value of RAI's identified intangible assets, a deferred tax asset of £472 million resulting from the fair value step-up of existing RAI debt as discussed in Note 5(b)(v) and a deferred tax liability of £213 million resulting from the fair value step-up of RAI inventory as discussed in Note 5(b)(vi), offset by the reversal of RAI's historical deferred tax balance of £8.4 billion on its historical value of identified intangible assets. Additionally, £891 billion of historical deferred tax assets were acquired.

(ix) Total net liabilities assumed excluding inventory, identifiable intangible assets, borrowings, net deferred taxes and goodwill was £1.4 billion. Fair value approximated carrying value; therefore, no adjustments were required for these balances. Property, plant and equipment is required to be measured at fair value unless those assets are classified as held-for-sale on the acquisition date. The acquired assets can include assets that are not intended to be used or sold, or that are intended to be used or sold, or that are intended to be used in a manner other than their highest and best use. BAT does not have sufficient information at this time as to the specific nature, age, condition or location of the land and land improvements, buildings and leasehold improvements, machinery and equipment and construction-in-process, and BAT does not know the appropriate valuation premise, in use or in exchange, as the valuation premise requires a certain level of knowledge about the assets being evaluated, as well as a profile of the associated market participants. All of these factors could result in differences between fair value and net book value. Accordingly, for the purposes of this Unaudited Pro Forma Financial Information, BAT believes, to the best of its knowledge that the current RAI carrying values represent the best estimate of fair value. This estimate is preliminary and subject to change and could vary materially from the actual adjustment included in the final purchase price allocation.

(x) The goodwill balance arising from the merger is estimated to be £40.7 billion, which represents an adjustment of £28.4 billion. The goodwill has been calculated as the excess of the sum of the purchase consideration of £41.7 billion and the £30.3 billion fair value of the equity interest already held by BAT at the time of the merger over the fair value of the net assets acquired of £31.3 billion. Goodwill represents a strategic premium for access to the U.S. market in which BAT previously did not operate and a premium paid for cost synergies expected to be achieved in the combined operations of BAT and RAI. Goodwill also arises due to the recognition of deferred tax liabilities in relation to the preliminary fair value adjustments on acquired intangible assets for which the amortization does not qualify as a tax deductible expense.

(xi) As part of the merger, BAT's previous equity method investment in RAI was eliminated as part of the step acquisition. A step acquisition occurs when a controlling ownership interest is gained over a period of time. The accounting guidance requires that the previously held equity interest be remeasured at fair value and any difference between the fair value and the carrying value of the previously held equity interest be recognized as a gain or loss in the income statement. The implied value of BAT's 42.2% of equity interest in RAI was determined using the value of the merger consideration of 0.5260 of a BAT ordinary share and $29.44 in cash, without interest, for each share of RAI common stock based on the closing share price of BAT ADSs on the NYSE MKT, and the exchange rate of £0.76517/$1, each as at transaction close. The carrying value of BAT's equity interest of £7.7 billion as of June 30, 2017 and profit after tax representing BAT's share of RAI's earnings of £1.9 billion for the year ended December 31, 2016 and £543 million for the six months ended June 30, 2017 have been eliminated in the Unaudited Pro Forma Financial Information. The resulting gain of £22.6 billion (£14.7 billion net of tax) from the step acquisition is included from the Unaudited Pro Forma Income Statement for the year ended December 31, 2016 and is nonrecurring in nature.

(c) Intercompany eliminations

Sales between, and balance due to and due from BAT and RAI have been eliminated in the Unaudited Pro Forma Financial Information. Sales from BAT to RAI amounted to £15 million for the year ended December 31, 2016 and £2 million for the six months ended June 30, 2017, and sales from RAI to BAT amounted to £167 million for the year ended December 31, 2016 and £52 million for the six months ended June 30, 2017. The associated payable and receivable positions as of June 30, 2017 of £1 million have been eliminated in the Unaudited Pro Forma Balance Sheet.

During the year ended December 31, 2016, BAT and RAI agreed to an early termination of a contract manufacturing agreement and as a result BAT agreed to make a compensation payment of $90 million to RAI, which BAT recognized in expense immediately and RAI recognized in deferred revenue. RAI is recognizing the deferred revenue into income pro-rata through December 31, 2018. Adjustments to eliminate this transaction from the Unaudited Pro Forma Income Statements reverse the £73 million charge recorded by BAT in 2016, the £9 million of other income recognized by RAI in 2016 and the £19 million of other loss recognized by RAI in the six months ended June 30, 2017.

(d) Impact to shareholders' equity

The estimated impact to total shareholders' equity is summarized as follows:

	Transaction and related costs(1)	Merger Eliminate RAI historical equity(2)	Issuance of BAT common stock(3)	Eliminate investment of associate	Fair value of investment of associate(4)	Contract manufacturing agreement(5)	Total merger adjustments to equity
				(in £ millions)			
Share capital	£ —	£ —	£ 108	£ —	£ —	£—	**£** 108
Share premium	—	(13,924)	23,030	—	—	—	9,106
Other reserves	—	17	—	—	—	—	17
Retained earnings	(125)	(3,058)	—	(7,674)	30,309	45	19,497
Owners of the parent	(125)	(16,965)	23,138	(7,674)	30,309	45	28,728
Non-controlling interest	—	—	—	—	—	—	**—**
Total shareholders' equity	**(125)**	**(16,965)**	**23,138**	**(7,674)**	**30,309**	**45**	**28,728**

(1) Refer to Note 5(a).

(2) Refer to Unaudited Pro Forma Balance Sheet.

(3) Refer to Note 5(b)(ii) and 5(b)(iv).

(4) Refer to Note 5(b)(xi).

(5) Refer to Note 5(c).

Note 6. Pro forma earnings per share

The weighted average number of BAT ordinary shares used in computing basic earnings per share has been calculated using the weighted average number of BAT ordinary shares issued and outstanding during the period and the number of shares of RAI common stock issued and outstanding as at the period end, giving effect to the exchange ratio established in the merger agreement. For the year ended December 31, 2016, the BAT pro forma basic earnings per share was calculated using 2,292 million weighted average shares, which reflects the 1,858 million weighted average of BAT ordinary shares issued and outstanding for the period and the 825 million shares of RAI common stock outstanding other than those held by BAT at December 31, 2016, converted to 434 million shares per the merger agreement. For the six months ended June 30, 2017, the BAT pro forma basic earnings per share was calculated using 2,292 million weighted average shares, which reflects the 1,858 million weighted average of BAT ordinary shares issued and outstanding for the period and the 825 million shares of RAI common stock outstanding other than those held by BAT at December 31, 2016, converted to 434 million shares per the merger agreement.

The 2,302 million weighted average number of BAT ordinary shares used in computing diluted earnings per share for the year ended December 31, 2016 has been calculated using the 2,292 million basic average number of BAT ordinary shares as per the paragraph above, adjusted for the dilutive impact of 7 million relevant to BAT, and 3 million relevant to RAI RSUs converted to 3 million shares per the exchange ratio set out in the merger agreement. The 2,300 million weighted average number of BAT ordinary shares used in computing diluted earnings per share for the six months ended June 30, 2017 has been calculated using the 2,292 million basic average number of BAT ordinary shares as per the paragraph above, adjusted for the dilutive impact of 5 million relevant to BAT, and 3 million relevant to RAI RSUs converted to 3 million shares per the exchange ratio set out in the merger agreement.

Note 7. Adjusting items

Adjusting items are defined in note 1 to the BAT Group's consolidated financial statements included in this Offering Memorandum.

As disclosed in note 3 to the BAT Group's 2016 consolidated financial statements included in this Offering Memorandum, adjusting items in the BAT Group's 2016 operating profit include:

- Restructuring and integration costs, totalling £603 million;
- Amortization and impairment of trademarks and similar intangibles charges totalling £149 million;
- Charges related to Fox River totalling £20 million; and
- South Korea sales tax charges totalling £53 million.

As disclosed in note 5 to the BAT Group's 2016 consolidated financial statements included in this Offering Memorandum, adjusting items in RAI's 2016 operating profit include:

- Gain in relation to the sale of the international rights to Natural American Spirit to JT International Holding BV, a subsidiary of Japan Tobacco Inc., of $4,861 million (£3,587 million);
- Implementation costs of $36 million (£27 million);
- Costs in respect of a number of *Engle* Progeny lawsuits and other tobacco litigation charges that amounted to $86 million (£63 million);
- Income of $6 million (£5 million) related to the Non-Participating Manufacturer (NPM) Adjustment claims of the states no longer challenging the findings of non-diligence entered against them by an Arbitration Panel;
- Transaction costs of $5 million (£4 million), connected with the merger; and
- Income relating to the early termination of the manufacturing agreement between BATUS Japan Inc. and RJR Tobacco Company of $90 million (£66 million).

As disclosed in note 3(b) to the BAT Group's unaudited condensed consolidated financial statements as of and for the six months ended June 30, 2017 included in this Offering Memorandum, adjusting items in the BAT Group's operating profit for the six months ended June 30, 2017 include:

- Restructuring and integration costs, totalling £133 million; and
- Amortization and impairment of trademarks and similar intangibles charges totalling £134 million.

As disclosed in note 3(d) to the BAT Group's unaudited condensed consolidated financial statements as of and for the six months ended June 30, 2017 included in this Offering Memorandum, adjusting items in the RAI Group's operating profit for the six months ended June 30, 2017 include:

- Restructuring costs of $33 million (£26 million); and
- Costs in respect of a number of *Engle* Progeny lawsuits and other tobacco litigation charges that amounted to $16 million (£13 million).

These adjusting items are not directly related to the merger, and have not been adjusted for in the Unaudited Pro Forma Financial Information, with the exception of the income related to the early termination of the manufacturing agreement, which is discussed above in Note 5(c).

Of the pro forma adjustments, adjusting items in the combined group operating profit would include transaction costs of £224 million (£176 million net of tax) for the year ended December 31, 2016, connected with the merger.

Accountant's report on Unaudited pro forma financial information

The Directors
British American Tobacco p.l.c.
Globe House
4 Temple Place
London
WC2R 2PG

9 August 2017

Ladies and Gentlemen

British American Tobacco p.l.c.

We report on the pro forma financial information (the "Pro forma financial information") set out in the section entitled "*BAT Unaudited Pro Forma Condensed Combined Financial Information*" of the Offering Memorandum dated 9 August 2017, which has been prepared on the basis described in note 1, for illustrative purposes only, to provide information about how the merger between British American Tobacco p.l.c. and its subsidiary undertakings (collectively "the Group") and Reynolds American Inc. and its subsidiary undertakings might have affected the financial information presented on the basis of the accounting policies adopted by the Group in preparing the consolidated financial statements for the period ended 31 December 2016 and the unaudited condensed consolidated financial statements for the six months ended 30 June 2017. This report is required by paragraph 7 of Annex II of the Prospectus Directive Regulation and is given for the purpose of complying with that paragraph and for no other purpose.

Responsibilities

It is the responsibility of the directors of British American Tobacco p.l.c. to prepare the Pro forma financial information in accordance with Annex II of the Prospectus Directive Regulation.

It is our responsibility to form an opinion, as required by paragraph 7 of Annex II of the Prospectus Directive Regulation, as to the proper compilation of the Pro forma financial information and to report that opinion to you.

In providing this opinion we are not updating or refreshing any reports or opinions previously made by us on any financial information used in the compilation of the Pro forma financial information, nor do we accept responsibility for such reports or opinions beyond that owed to those to whom those reports or opinions were addressed by us at the dates of their issue.

Save for any responsibility arising under regulation 6(1)(e) of the Financial Services and Markets Act 2000 (Official Listing of Securities) Regulations 2001 to any person as and to the extent there provided, to the fullest extent permitted by law we do not assume any responsibility and will not accept any liability to any other person for any loss suffered by any such other person as a result of, arising out of, or in connection with this report or our statement, required by and given solely for the purposes of complying with paragraph 13.1 of Annex IX of the Prospectus Directive Regulation, consenting to its inclusion in the Offering Memorandum.

Basis of Opinion

We conducted our work in accordance with the Standards for Investment Reporting issued by the Auditing Practices Board in the United Kingdom. The work that we performed for the purpose of making this report, which involved no independent examination of any of the underlying financial information, consisted primarily of comparing the unadjusted financial information with the source documents, considering the evidence supporting the adjustments and discussing the Pro forma financial information with the directors of British American Tobacco p.l.c.

We planned and performed our work so as to obtain the information and explanations we considered necessary in order to provide us with reasonable assurance that the Pro forma financial information has been properly compiled on the basis stated and that such basis is consistent with the accounting policies of British American Tobacco p.l.c.

Our work has not been carried out in accordance with auditing or other standards and practices generally accepted in the United States of America and accordingly should not be relied upon as if it had been carried out in accordance with those standards and practices.

Opinion

In our opinion:

- the Pro forma financial information has been properly compiled on the basis stated; and
- such basis is consistent with the accounting policies of British American Tobacco p.l.c.

Declaration

For the purposes of regulation 6(1)(e) of the Financial Services and Markets Act 2000 (Official Listing of Securities) Regulations 2001 we are responsible for this report as part of the listing particulars and declare that we have taken all reasonable care to ensure that the information contained in this report is, to the best of our knowledge, in accordance with the facts and contains no omission likely to affect its import. This declaration is included in the Offering Memorandum in compliance with paragraph 1.2 of Annex IX of the Prospectus Directive Regulation.

Yours faithfully

/s/ KPMG LLP

KPMG LLP

BUSINESS OF BAT

Overview

BAT is the parent holding company of the BAT Group, a global tobacco and next generation products group with brands sold in over 200 markets. According to the BAT Group's internal estimates, the BAT Group is a market leader in more than 55 countries by volume, producing the cigarette chosen by one in eight of the world's one billion smokers. The BAT Group, excluding the BAT Group's associated undertakings, is organized into four regions: Asia-Pacific, Americas, Western Europe and Eastern Europe, Middle East and Africa, referred to as EEMEA.

In 2016, the BAT Group sold approximately 665 billion cigarettes (excluding sales of its associates) of which approximately 630 billion cigarettes were produced by 44 factories in 42 countries. In 2016, the BAT Group's five global drive brands accounted for 49% of the BAT Group's total cigarette volume. The BAT Group's range of products covers all segments, from value-for-money to premium with a portfolio of international, regional and local tobacco brands to meet a broad array of adult tobacco consumer preferences wherever the BAT Group operates. The BAT Group is investing in building a portfolio of innovative new types of tobacco and nicotine products alongside its traditional tobacco business. These next generation products include vapor products (such as e-cigarettes) and tobacco heating products.

The BAT Group manages a globally integrated supply chain and the BAT Group's products are distributed to retail outlets worldwide. During 2016, the BAT Group employed around 50,000 people worldwide.

In 2016, the BAT Group's revenue was £14,751 million and its profit from operations was £4,655 million. For the six months ended June 30, 2017, the BAT Group's revenue was £7,717 million and its profit from operations was £2,574 million.

History and Development of BAT

BAT has had a significant global presence in the tobacco industry for over 100 years. The British-American Tobacco Company Ltd., referred to as BAT Ltd., was incorporated in 1902, when the Imperial Tobacco Company and the American Tobacco Company agreed to form a joint venture company. BAT Ltd. inherited companies and quickly expanded into major markets, including India and Ceylon, Egypt, Malaya, Northern Europe and East Africa. In 1927, BAT Ltd. expanded into the U.S. market through its acquisition of B&W.

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

In 1999, the BAT Group announced a global merger with Rothmans International, at that time the fourth largest tobacco company in the world. The BAT Group acquired Imperial Tobacco Canada in 2000, and in 2003 the BAT Group acquired Ente Tabacchi Italiani S.p.A., Italy's state-owned tobacco company. Investments were made in Peru and Serbia in 2003, through the acquisitions of Tabacalera Nacional and Duvanska Industrija Vranje. In July 2004, the U.S. assets, liabilities and operations, other than certain specified assets and liabilities, of BAT's wholly owned subsidiary, B&W, were combined with RJR Tobacco Company. RAI was previously formed as a new holding company for these combined businesses and B&W acquired beneficial ownership of approximately 42% of RAI's outstanding common stock. In 2008, the BAT Group acquired Tekel, the Turkish state-owned tobacco company, as well as 100% of the cigarette and snus business of Skandinavisk Tobakskompagni A/S. Following the acquisition of its business during 2009, the BAT Group recognized an effective 99% interest in Bentoel in Indonesia. In 2011, the BAT Group completed the acquisition of 100% of Protabaco in Colombia. In 2012, the BAT Group acquired CN Creative Limited, a UK-based start-up company specializing in the development of e-cigarette technologies. During 2013, the BAT Group entered into joint operations in China and Myanmar. In 2015, the BAT Group acquired the shares it did not already own in Souza Cruz; 100% of Blue Nile Cigarette Company Limited, a tobacco manufacturing and distribution company in the Republic of Sudan; 100% of the CHIC Group, a vapor product business in Poland and TDR d.o.o., a cigarette manufacturer in Central Europe. In 2015, in connection with the Lorillard merger, the BAT Group also invested $4.7 billion to maintain its 42% equity position in the enlarged RAI, following the Lorillard merger. Following the completion of the merger, RAI has become an indirect, wholly owned subsidiary of BAT and is no longer a publicly held corporation. In 2016, the BAT Group acquired Ten Motives, a UK based e-cigarette business with particular strength in traditional grocery and convenience channels.

BAT was incorporated in July 1997 under the laws of England and Wales as a public limited company and is domiciled in the United Kingdom. BAT is the parent holding company of the BAT Group, which is involved in activities directly or indirectly related to the manufacture, distribution or sale of cigarettes and other tobacco and nicotine products.

Significant Recent Business Combinations and Acquisitions

On July 25, 2017, RAI became an indirect, wholly owned subsidiary of BAT. For more information, see *"The Merger"*.

In 2016 and 2015, the BAT Group made the following significant business combinations and acquisitions:

- During 2015, the BAT Group invested £1.7 billion to acquire the shares it did not already own in its Brazilian subsidiary, Souza Cruz, and de-listed the company. Following a public auction in October 2015, the BAT Group acquired sufficient shares to cancel Souza Cruz's registration as a publicly listed company, with a total shareholding of 99.1%. The compulsory acquisition of the remaining minority shares was approved on February 5, 2016, with Souza Cruz becoming a wholly owned subsidiary at that date.
- In September 2015, the BAT Group completed the acquisition of TDR d.o.o., a cigarette manufacturer in Central Europe, and other tobacco and retail assets, referred to as TDR, from Adris Grupa d.d. for a total enterprise value of €550 million.

The BAT Group made no significant business combinations or acquisitions in 2014.

Strengths

We believe that our principal strengths are the following:

Brand Portfolio

Our balanced and internationally recognized portfolio of brands is designed to deliver continued growth and includes our five GDBs, Dunhill, Kent, Lucky Strike, Pall Mall and Rothmans, our other International Brands and local brands. Our GDBs represent a growing part of our total portfolio, but we have many other internationally recognizable brands and local brands that play a key role in our strategy, including Benson & Hedges, Craven A, John Player Gold Leaf, Kool, Newport, Peter Stuyvesant, Shuang Xi, State Express 555, Viceroy and Vogue. Our business is about understanding and meeting the different profiles and preferences of adult smokers and our range of brands means that we can offer adult consumers a choice across all price points. Our product portfolio includes a wide range of cigarettes, other tobacco products, including cigars, roll-your-own tobacco, moist snuff and Swedish-style snus, and next generation products.

Geographic Spread

Our products are sold in more than 200 markets around the world and we have a leadership position in more than 55 markets. In addition, we are the major shareholder in ITC, the largest tobacco company in India. Our geographic diversity means that we have strong positions in mature, developing and emerging markets and are less exposed to specific markets or market types.

Innovation Pipeline

We make significant investments in research and development to deliver innovations that satisfy or anticipate consumer needs and generate growth for our business. With a highly integrated supply chain, we have introduced innovative tobacco products throughout the world, such as capsule products, additive-free products, slim-format products, tube filters and Reloc, our resealable pack technology. These innovations now account for over one quarter of our total cigarette sales. We also look outside the traditional cigarette market and research, develop and test next generation products.

Global Scale

We have a global approach to managing our supply chain, which spans from crop to consumer, covering direct agronomy services support to leaf growers, direct and indirect procurement, product manufacturing and distribution, with the aim of reducing complexity and rationalizing manufacturing sites and suppliers (where appropriate) to leverage economies of scale while enhancing quality standards.

People and Relationships

We employ around 55,000 people worldwide. Our workforce is strongly multicultural and we have a devolved structure, with each local company having responsibility for its operations. We encourage a culture of personal ownership and value our employees' talents. Their diverse perspectives help us to succeed. We have a large network of suppliers and we are committed to helping enable prosperous livelihoods for all farmers who supply our tobacco leaf. Trade marketing is a large part of our activity and involves managing business-to-business relationships with the retailers our adult consumers buy from. We place a strong emphasis on being a high-quality supplier to the trade.

Next Generation Products

We are complementing our core tobacco business by offering adult consumers a wide choice of alternative tobacco and nicotine products, including e-cigarettes and tobacco heating products. We are investing significantly in this category because it is an exciting new opportunity for us, and one which we hope will be able to support a reduction in smoking related diseases to the benefit of society. We estimate that we are the largest international company group in the vapor market outside the United States and RJR Vapor is one of the leading vapor brands companies in the US.

Strategy

Our vision is to be the world's best at satisfying consumer moments in tobacco and beyond. Adult consumers are at the core of everything we do and our success depends on addressing their evolving concerns, needs and behaviors. Tobacco remains at the core of our business and will continue to provide us with opportunities for growth. We are also committed to developing and promoting a range of next generation products, the term we use to describe new types of tobacco and nicotine products.

Our mission is to deliver our commitments to society, while championing informed consumer choice. Our strategy is based on four factors: *growth, productivity, building a winning organization* and *sustainability*.

Growth

We will grow by understanding and delivering enjoyable consumer moments in combustibles and next generation products. Our approach is to be consumer led, product obsessed, brand distinct and excellent in execution.

We aim to increase our market share in our key markets. A key part of this is the ongoing development and expansion of our five GDBs, Dunhill, Kent, Lucky Strike, Pall Mall and Rothmans. Our objective is to increase the share of our GDBs faster than the rest of our portfolio. We will do this by expanding the geographic footprint of the GDBs and rolling out consumer relevant innovations under these brands. We continue to invest in the development of innovative products that offer adult consumers meaningful, value added differentiation, and to take measures to ensure the successful deployment of such innovations, in order to achieve organic growth.

We also seek to continue to invest in our other internationally recognized, regional and local brands that play an important role in our portfolios in many markets. Examples include Benson & Hedges, Craven A, Derby, John Player Gold Leaf, Kool, Newport, Peter Stuyvesant, Shuang Xi, State Express 555, Viceroy, Vogue and Yava.

We focus on key market segments that offer the best long-term growth prospects. An example is the premium segment, where products are sold at a higher price than the average in a particular market. We also aim to maintain or develop strong positions in our largest and most profitable markets. Strategically important and financially attractive mergers and acquisitions may also provide us with growth opportunities. See *"— History — Significant Business Combinations and Acquisitions*".

We are committed to leading in next generation products. We are focusing on two distinct categories, vapor products and tobacco heating products, which we believe have the potential to be both significantly less risky than conventional cigarettes and have widespread consumer appeal. We are investing significantly in this category, including through the roll out of our vapor product brand, Vype, behind VUSE, which is already one of the leading brands in the US, and our advanced tobacco heating product, glo.

Productivity

Productivity is a key pillar to support growth. It is about effectively deploying resources to increase profits and generate funds to invest behind growth. Our approach is to be operationally best, globally integrated and to ensure cost and capital effectiveness.

Being operationally best means being more efficient and effective across our entire supply chain to deliver market-leading products and innovations to our markets to satisfy adult consumers, drive share growth and create value for our partners. This involves investing in new machinery and equipment, as well as in global planning systems and processes.

We are becoming a faster and more effective globally integrated enterprise following the implementation of a standard operating model underpinned by a global SAP system. With consistent ways of working, better information and higher levels of automation we are able to operate faster and move more services above market.

Becoming more integrated will also deliver cost savings with the on-going optimization of our manufacturing footprint and procurement initiatives that take full advantage of our global scale. Our strategy is to further reduce our cost base by focusing on making our operations flexible, agile and truly consumer-centric. We are also continuing to focus on reducing overheads and indirect costs. We will continue to deploy our capital productively by ensuring that resources are allocated in the right areas and by effectively using our cash and other assets.

Building a Winning Organization

To achieve our vision, we recognize that we must continue to have the right people, organized in the right teams and in the right working environment. Our aim is to maintain a high-performing organization that attracts, develops and retains talented people. When we recruit, we seek to bring in people who will provide additional knowledge and skills that will strengthen our teams and ultimately make us a stronger business. We develop our leaders from within our business and have clear leadership capabilities. We continue to improve our retention of high-performing leaders and focus on having strong succession plans for critical roles. We value diversity and have a specific ambition to achieve a sustainable improvement in senior representation of women and nationalities across the business.

Sustainability

We want to ensure we continue to have a sustainable future so we can continue to meet the expectations of our adult consumers, our shareholders and other stakeholders. Our approach is focused on three areas that are most significant for a sustainable future: harm reduction, sustainable agriculture and farmer livelihoods and corporate behavior.

We research, develop and promote a range of innovative tobacco and nicotine products which could offer adult consumers a choice of less risky alternatives to regular cigarettes. This could benefit public health, while also supporting the future growth of our business.

We work to enable prosperous livelihoods for all farmers who supply our tobacco leaf. This involves: helping farmers to have profitable businesses; preserving natural resources; investing in farming communities; developing skills, knowledge and labor; and strengthening community networks.

We are committed to operating to the highest standards of corporate conduct and transparency across our business. Our approach includes engaging openly on regulation; responsible marketing of tobacco products and working with retailers to prevent youth smoking; collaborating with others to tackle the illegal tobacco trade; safeguarding human rights across our own operations and our supply chain; protecting the health and safety of our workforce; and addressing the environmental impacts of our business operations.

The following discussion of the BAT Group is limited to the BAT Group prior to the merger and does not cover the BAT Group's business activities in the United States. For a discussion of the BAT Group's U.S. business, see "*Business of RAI*".

Business Segments

The BAT Group, excluding the BAT Group's associated undertakings, is organized into four regions: Asia-Pacific, Americas, Western Europe and Eastern Europe, Middle East and Africa, referred to as EEMEA. For more information about adjusted profit from operations, including a reconciliation to profit from operations, see "*Summary Historical Consolidated Financial Data of BAT*".

The Western Europe region encompasses Western Europe and parts of Central Europe, including Poland, Romania, Bulgaria, Serbia, Croatia, Montenegro, Albania and Kosovo. In 2016, the volume for the Western Europe region was 120 billion (compared to 112 billion in 2015 and 2014). In 2016, revenue from the Western Europe region was £3,867 million (compared to £3,203 million in 2015 and £3,359 million in 2014), which is 26.2% of the BAT Group's total consolidated revenue, profit from operations was £1,044 million and adjusted profit from operations was £1,389 million, representing 21.6% and 28.7% of the BAT Group's total profit, respectively.

The Asia-Pacific region encompasses South Korea, the markets of South-East Asia, South Asia, Japan and Australasia. In 2016, the volume for the Asia-Pacific region was 196 billion (compared to 198 billion in 2015 and 197 billion in 2014). In 2016, revenue from the Asia-Pacific region was £4,266 million (compared to £3,773 million in 2015 and £3,873 million in 2014), which is 28.9% of the BAT Group's total consolidated revenue, profit from operations was £1,432 million and adjusted profit from operations was £1,630 million, representing 29.6% and 33.7% of the BAT Group's total profit, respectively.

The Americas region encompasses the markets of Central America and South America, the Caribbean, Canada and Mexico. In 2016, the volume for the Americas was 113 billion (compared to 124 billion in 2015 and 131 billion in 2014). In 2016, revenue from the Americas was £2,868 million (compared to £2,720 million in 2015 and £2,990 million in 2014), which is 19.4% of the BAT Group's total consolidated revenue, profit from operations was £1,017 million and adjusted profit from operations was £1,172 million, representing 21.0% and 24.2% of the BAT Group's total profit, respectively.

The EEMEA region encompasses Eastern Europe, which includes Russia, Ukraine, Moldova, Belarus, the Caucasus, the Middle East and Africa. In 2016, the volume for the EEMEA region was 236 billion (compared to 229 billion in 2015 and 227 billion in 2014). In 2016, revenue from the EEMEA region was £3,750 million (compared to £3,408 million in 2015 and £3,749 million in 2014), which is 25.4% of the BAT Group's total consolidated revenue, profit from operations was £1,182 million and adjusted profit from operations was £1,289 million, representing 24.4% and 26.6% of the BAT Group's total profit, respectively.

Brands and Products

The BAT Group's core tobacco product range includes cigarettes, Fine Cut (roll-your-own and make-your-own tobacco), Swedish-style snus and cigars. The BAT Group's range of products covers all segments, from value-for-money to premium products. In addition, the BAT Group also develops and sells next generation products and is currently focusing on two distinct categories: vapor products (such as e-cigarettes) and tobacco heating products.

The BAT Group's cigarette portfolio is composed of global drive brands, international brands and local brands. The BAT Group's five global drive brands play a key role in its growth strategy. In 2016, global drive brands volume represented 49% of the BAT Group's global cigarette volume, up from 35% in 2011. The international and local brands help maintain the BAT Group's broad brand portfolio worldwide, with strong market positions in many key markets, such as Brazil, Canada, South Africa, Turkey, Nigeria, Denmark, Norway, Australia, Vietnam, Pakistan, Bangladesh and Japan.

The following discussion of the BAT Group brands is limited to the BAT Group's portfolio prior to the merger and does not cover the sale or marketing of these brands in the United States. For a discussion of the BAT Group's U.S. business, see *Business of RAI*.

The BAT Group's five global drive brands are:

- Dunhill;
- Kent;
- Lucky Strike;
- Pall Mall; and
- Rothmans.

The BAT Group's other international brands include:

- Vogue;
- Viceroy;
- Kool;
- Peter Stuyvesant;
- Craven A;
- Benson & Hedges;
- John Player Gold Leaf;
- State Express 555; and
- Shuang Xi.

Global Drive Brands

Dunhill

The Dunhill brand for tobacco products was launched in 1907. In 1999, as part of the BAT Group's merger with Rothmans International, the BAT Group acquired Dunhill Tobacco of London Limited, including all of the Dunhill brand of cigarettes, cigars and tobacco products. The Dunhill brand range includes a diverse range of cigarettes and cigars that can command premium or above premium prices. The BAT Group's Dunhill brand is sold in more than 100 markets. In 2016, total Dunhill volume decreased compared to 2015 by 3.3% to 57 billion (representing 8.5% of the BAT Group's global volume), driven mainly by industry declines in Malaysia and Brazil, which more than offset growth in South Korea and the continued growth in Indonesia.

In recent years, the BAT Group has enhanced Dunhill's position in various key markets, including the successful entry of the brand into Indonesia (following the acquisition of Bentoel), and through the delivery of innovative cigarette products such as new capsule offers and the BAT Group's Reloc product innovation using re-sealable pack technology distinctive to Dunhill. The roll-out of the BAT Group's super-premium variant Fine Cut has also helped to expand Dunhill into a number of new markets.

Kent

The BAT Group believes Kent is a market leader in the tobacco industry for innovation. The Kent brand is sold in more than 70 markets. In 2016, total Kent volume increased compared to 2015 by 1.0% to 66 billion (representing 10.0% of the BAT Group's global volume), driven by increased sales in Chile, Turkey, Japan and Russia.

In recent years, the BAT Group has developed a number of innovations in respect of the Kent brand. Kent Convertibles, the innovative range of capsule products launched in 2010, continues to expand into new markets and has played a key role in generating volume growth and reinforcing Kent's status as a leader in innovation. Also, Kent has expanded its slimmer formats to continue driving share growth in the super slim premium segment. Packaging improvements implemented across the BAT Group's core range and a recent launch of the tube filter have also strengthened the BAT Group's brand and resulted in share gains in important markets such as Japan and Turkey.

Lucky Strike

The Lucky Strike brand was launched in 1871. In 1994, the Lucky Strike brand was added to the BAT Group's portfolio, through the acquisition of the American Tobacco Company. In 2016, total Lucky Strike volume increased compared to 2015 by 13.5% to 36 billion (representing 5.5% of the BAT Group's global volume), with growth in Indonesia, Colombia, Egypt, France, Croatia and Italy, which more than offset reductions in Argentina and Russia. The Lucky Strike brand is sold in more than 80 markets.

Lucky Strike has continued its growth through the Lucky Strike Click & Roll capsule product particularly in the Americas region and in France. The Adult Smokers Under 30 market segment accounts for a significant percentage of the brand's franchise and the BAT Group continues to focus on this market segment through consumer-relevant innovation.

Pall Mall

The Pall Mall brand was introduced in 1899 by the Black Butler Company. In 1994, the Pall Mall brand was added to the BAT Group's product portfolio, through the acquisition of the American Tobacco Company. Pall Mall is the BAT Group's leading global value-for-money brand. Based on the BAT Group's internal estimates, using the declared brand volumes of its key competitors, Pall Mall is the fourth biggest global brand. In 2016, total Pall Mall volume increased compared to 2015 by 0.1% to 92 billion (representing 13.9% of the BAT Group's global volume), as growth in Venezuela, Poland, Iran, Mexico and Romania more than offset reductions in Pakistan and the migration to Rothmans in Italy. Pall Mall is sold in more than 110 markets.

Pall Mall's products include the BAT Group's global core offer, along with menthol, capsules, extra cut and additive-free ranges.

Rothmans

The Rothmans brand was established in London in 1890 by its founder, Louis Rothman. The Rothmans brand was acquired by the BAT Group following its global merger with Rothmans International in 1999. In 2016, total Rothmans volume increased compared to 2015 by 36.9% to 73 billion (representing 10.9% of the BAT Group's global volume), driven by an increase in volumes in Russia, Ukraine, Italy, Nigeria, Turkey and South Korea. Rothmans is currently available in over 80 markets around the world.

Local and International Brands

Although the BAT Group's local and international brands are undergoing a slow decline, representing 36.1% and 15.2% of total BAT Group volume and down 4.4% and 9.0% in 2016, respectively, these brands continue to play an important role in delivering the BAT Group's strategy in several key markets, including South Africa, Vietnam, Pakistan, Bangladesh and Japan. These brands are also predominantly the source of migrations to the BAT Group's global drive brands. International brands include Vogue, Viceroy, Kool, Peter Stuyvesant, Craven A, Benson & Hedges, John Player Gold Leaf, State Express 555 and Shuang Xi. The BAT Group's portfolio also includes important local brands which enjoy high consumer loyalty, such as Yava in Russia and Derby in Brazil. These brands assist the BAT Group in maintaining a broad brand portfolio worldwide.

Next Generation Products

The two main categories of next generation products are: vapor products (such as e-cigarettes), which are battery powered electronic devices which heat a solution to create a vapor which can be inhaled and tobacco heating products, which are battery powered electronic devices that operate with specifically designed consumables containing tobacco, to deliver a real tobacco taste and aroma. While still a nascent market, the global vapor products category is currently the larger of the two and continues to grow at a significant rate in certain key markets. Today, tobacco heating products are a smaller category but one that is growing, particularly in Japan, and the category is expanding to other markets, including in Europe.

The BAT Group is one of the largest international companies in the vapor market outside of the United States and China, having successfully launched a portfolio of products in the five largest vapor markets in Europe and established significant market share in the United Kingdom and Poland, based on the BAT Group's internal estimates.

The BAT Group's leading vapor product brand is Vype, which is available in ten countries following a geographic expansion in 2016, including the launch of Vype in the United Kingdom in 2013 and the opening of the first Vype retail concept store in Milan in 2016. The BAT Group has six different Vype devices available to adult tobacco consumers, as well as a variety of e-liquid flavors and nicotine strengths, including a nicotine-free option. The newest addition to the BAT Group's portfolio of vapor products is the Vype Pebble, which is a small, portable device that is simple to use. Currently, the BAT Group is consumer testing its first Vype device using a new vaping technology developed in partnership with an independent inventor, which would replace the current "coil and wick" system. In December 2016, the BAT Group launched a tobacco heating product, called glo, in Sendai, Japan, which provides an experience to adult tobacco consumers similar to that of a cigarette. The BAT Group's other tobacco heating product, the iFuse product, blends vaping technology with tobacco. The iFuse product was launched in Romania in 2015 as a test market, and further development of this platform is scheduled to take place in 2017.

To provide a globally consistent and responsible approach to the marketing of its vapor products, in 2015, the BAT Group developed and published its vapor product Marketing Principles, which are aligned to the UK Committee of Advertising Practice Codes. The BAT Group is currently working on the development of new Marketing Principles for tobacco heating products.

Procurement

While the BAT Group does not own tobacco farms or directly employ farmers, it sources over 400,000 tons of tobacco leaf each year directly from over 90,000 contracted farmers and through third-party suppliers mainly in developing countries and emerging markets in Africa, Asia and Latin America. The BAT Group also purchases tobacco leaf from India where the tobacco is bought over an auction floor. In 2016, the BAT Group entered into commitments to buy 80% of its leaf from its principal sources, located in 14 countries. The price of tobacco in U.S. dollars varies from year to year driven by domestic inflationary pressures, supply, demand and quality. The BAT Group believes there is an adequate supply of tobacco leaf in the world markets to satisfy its current and anticipated production requirements.

The BAT Group also purchases other raw materials, such as packaging materials, filters and paper, from other international suppliers. The e-liquids used in the BAT Group's vapor products are made from pharmaceutical grade nicotine sourced from third-party manufacturers. The BAT Group's next generation products are mainly manufactured in third-party factories.

The BAT Group continues to implement and realize the benefits of a new global operating model with common systems, processes and ways of working across its worldwide businesses. This has helped drive further savings through greater global integration between end-markets, regional and global subfunctions. Examples of

this are the increased use of shared services for back office functions, a global supply planning center in Southampton, United Kingdom and the establishment in 2016 of a new Global Leaf Operations Centre in Brazil which helps export best agronomic practice across the BAT Group.

The BAT Group has invested at least £60 million in each of the last three years to provide on-the-ground support and advice to its contracted farmers. In 2016, the BAT Group replaced its Social Responsibility in Tobacco Production program with the Sustainable Tobacco Programme, referred to as STP. This is an industry-wide initiative developed in collaboration with five other manufacturers to bring together best practice from across the industry. It is also aligned to important external standards, such as those of the International Labour Organization, and includes strengthened processes and more frequent on-site reviews of leaf suppliers. STP covers areas such as sustainable farming techniques, the use of agrochemicals, soil and water management and actions that can be taken to help prevent child labor, forced labor and to create safer working environments.

STP has been adopted by all major global tobacco manufacturers and their leaf suppliers. Its aim is to provide a more consistent and robust way of assessing suppliers' performance, reducing complexity and driving continuous improvement across the global tobacco leaf supply chain. STP was rolled out across the BAT Group's leaf supply chain in 2016 through a series of training and regional workshops.

Manufacturing

In 2016, the BAT Group sold approximately 665 billion cigarettes (excluding sales of its associates) of which approximately 630 billion cigarettes were produced by 44 cigarette factories in 42 countries. The BAT Group's factory outputs and establishments vary significantly in size and production capacity. For example, the BAT Group's site in St. Petersburg, Russia has an annual output of about 45 billion cigarettes and over 500 employees whereas one of the BAT Group's smallest factories in Fiji has an annual output of about 330 million cigarettes and approximately 50 employees. In addition, the BAT Group has 18 green leaf threshing plants, where leaf received from the farmers is processed, and three factories that produce other tobacco products, such as roll-your-own tobacco, make-your-own and snus. In total, approximately 18,000 employees work within the BAT Group's manufacturing operation. The BAT Group uses a mixture of in-house and contract manufacturers to manufacture its next generation products.

BAT-Owned Manufacturing Facilities[(1)]

	Western Europe	Asia-Pacific	Americas	EEMEA	Total
Fully Integrated (cigarettes/other tobacco products)	7	11	7	9	34
Make-pack	0	4	0	6	10
Other	2	0	0	0	2
Total	9	15	7	15	46

Note:

(1) As of December 31, 2016.

The plants and properties owned or leased and operated by the BAT Group's subsidiaries are maintained in good condition and are believed to be suitable and adequate for the BAT Group's present needs. As a result of the recent acquisition of the Blue Nile Cigarette Company Limited, the BAT Group is currently investing in bringing an acquired factory to a condition deemed appropriate by the BAT Group. The BAT Group plans to close its factory in Bayreuth, Germany by the end of 2017 and to transfer its production to existing factories in Poland, Romania, Hungary and Croatia.

The technology employed in cigarette factories is sophisticated, especially in the area of cigarette making and packing where throughputs can reach between 500 and 1000 packs per minute. The BAT Group can produce many different pack formats (e.g., the number of cigarettes per packet) and configurations (e.g., bevel edge, round corner, international) to suit marketing and consumer requirements. New technology machines are sourced from the leading machinery suppliers to the industry. Close cooperation with these organizations helps the BAT Group support its marketing strategy by driving its product innovations, which are brought to the market on a regular basis.

The BAT Group utilizes quality standards, processes and procedures covering the entire end-to-end value chain to help to ensure quality products are provided to its customers and adult tobacco consumers according to the BAT Group's requirements and end market regulatory requirements.

The BAT Group has several improvement initiatives which it is currently managing. For example, the BAT Group is continuing to realize the benefits of its Integrated Work System Program launched in 2014, which is centrally led with an aim to improve the performance of the BAT Group's factories globally by focusing on

manufacturing standards, continuous improvement, assessment and benchmarking and organizational development. The BAT Group also utilizes a survey process in the factories with an aim to improve factory productivity and reduce costs in the manufacturing environment. This process, known as "Bulls Eye", has been in existence for a number of years and highlights productivity opportunities by benchmarking.

Customers

No BAT Group customer accounted for 10% or more of the BAT Group's consolidated revenue during 2016, 2015 or 2014. There is no concentration of credit risk with respect to trade receivables as the BAT Group has a large number of internationally dispersed customers.

Distribution, Sales and Marketing

The BAT Group's products are distributed to retail outlets around the world, including supermarkets, convenience stores, hotels, restaurants, cafes, tobacconists and duty free shops. The BAT Group recognizes the importance of retail outlet distribution and, as part of its trade communication and distribution strategy, the BAT Group has adopted a direct and exclusive distribution approach, or "direct store sales", by identifying and working with the retail outlets to develop a commercially based and strategic relationship. Direct store sales provide the BAT Group with visibility and control over the distribution of its products, allowing the BAT Group to access both the market and consumer information. Such sales also provide a direct commercial link to the BAT Group's most strategic retail accounts. Around half of the BAT Group's global cigarette volume is sold by retailers, supplied through the BAT Group's direct distribution capability or exclusive distributors. The BAT Group continuously reviews its route to market for combustible products and next generation products, including its relationships with wholesalers, distributors and logistics providers.

The BAT Group additionally has hundreds of local and regional wholesale customers and actively works with key global corporate retailer partners. These very large businesses operate mainly in the grocery, convenience stores and gas station distribution channels. The BAT Group continues to further develop joint programs with its global retail partners in order to better reach adult smokers in key channels such as global travel retail and convenience. The BAT Group believes that its routes to market are critical and allow the BAT Group to roll out innovations effectively and quickly on a global scale as well as to meet consumer demand at the point of sale.

In addition, the BAT Group trains its trade marketing and distribution staff to successfully support its brands and innovations in a fast-paced and rapidly changing environment to meet the demands of retailers and adult tobacco consumers. The BAT Group has over 20,000 trade marketing and distribution staff.

The BAT Group's marketing is based on understanding adult tobacco consumers and giving them relevant choices. The BAT Group gathers insights into adult tobacco consumers' smoking preferences and buying behavior to understand the different profiles of its adult tobacco consumers, before investing in developments across the marketing mix to deliver relevant choices for the BAT Group's adult tobacco consumers. This assists the BAT Group in ensuring its products satisfy the preferences of adult tobacco consumers.

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

- understanding the different profiles and preferences of its customers;
- the strength of its brands;
- its consumer-centric innovative products; and
- world class trade marketing.

The BAT Group believes there should be marketing restrictions for products which pose real and serious risks to health, such as tobacco products. The BAT Group seeks to apply a consistent, responsible approach to marketing across the BAT Group by requiring that its companies follow its International Marketing Principles, which govern the BAT Group's marketing of all combustible tobacco products. The BAT Group's International Marketing Principles provide that its marketing should be targeted at adult tobacco consumers and not undermine their understanding of the health risks and include, for example, further procedures for adult verification and for the responsible use of new and emerging channels of consumer communication. The BAT Group's International Marketing Principles are its minimum standards and are applied even when they are stricter than local laws. However, if local laws or other voluntary codes in markets are stricter than or override the International Marketing Principles, then the BAT Group abides by those laws or voluntary codes. The BAT Group monitors adherence to its International Market Principles through market audits and annual self-assessments.

Regulation

Overview

The BAT Group's businesses operate under increasingly stringent regulatory regimes worldwide. The tobacco industry is one of the most highly regulated in the world, with manufacturers required to comply with a variety of different regulatory regimes across the globe. The BAT Group continues to respond to these regimes and engages with governments and other regulatory bodies to find solutions to changing regulatory landscapes. Restrictions on the manufacture, sale, marketing and packaging of tobacco products are in place in nearly all countries and markets.

Regulation can typically be categorized as follows:

- *Place:* including regulations restricting smoking in private, public and work places (e.g., public place smoking bans);
- *Product:* including regulations on the use of ingredients, product design and attributes (e.g., ceilings regarding tar, nicotine and carbon monoxide yields, as well as restrictions on flavors); product safety regulations (e.g., General Product Safety Directive (2001/95/EC), electrical safety regulations and reduced cigarette ignition propensity standards) and regulatory product disclosure requirements (e.g., in relation to ingredients and emissions);
- *Packaging and labeling*: including regulations on health warnings and other government-mandated messages (e.g., in respect of content, positioning, size and rotation); restrictions on the use of certain descriptors and brand names; requirements on pack shape, size, weight and color and mandatory plain packaging;
- *Sponsorship, promotion and advertising*: including partial or total bans on tobacco advertising, marketing, promotions and sponsorship and restrictions on brand sharing and stretching (the latter refers to the creation of an association between a tobacco product and a non-tobacco product by the use of tobacco branding on the non-tobacco product);
- *Purchase*: including regulations on the manner in which tobacco products are sold, such as type of outlet (e.g., supermarkets and vending machines) and how they are sold (e.g., above the counter versus beneath the counter); and
- *Price:* including regulations which have implications for the prices which manufacturers can charge for their tobacco products (e.g., excise and minimum prices).

World Health Organization Framework Convention on Tobacco Control

Much of the recent development in regulation at a global level has been driven by the FCTC. The FCTC came into force in 2005 and contains provisions aimed at, among other things, reducing tobacco consumption and toxicity. The original treaty is supplemented by protocols and guidelines. While these guidelines are not legally binding, they provide a framework of recommendations for parties to the guidelines.

To date, the FCTC has been ratified by over 180 countries, not including the United States. The FCTC has led to increased efforts by tobacco-control advocates and public health organizations to reduce the supply of and demand for tobacco products, and to encourage governments to further regulate the tobacco industry. As national regulations increasingly reflect global influences, the scope of areas regulated will likely further expand. The guidelines on advertising, promotion and sponsorship, for example, seek to broaden the definition of tobacco advertising to include product display, the use of vending machines as well as the design of the pack itself.

Where adopted by contracting parties, a number of the measures referred to in the guidelines may result in either additional costs for the tobacco industry or restrictions on a manufacturer's ability to differentiate its products and communicate those differences to adult smokers. For example, a change in the number and size of on-pack health warnings requires new printing cylinders to be commissioned, while the implementation of new plant protection product standards, product testing and the submission of ingredients information to national governments require extensive resources, time and material.

EU Tobacco and Related Products Directive (2014/40/EU)

Other developments in regulation have been driven by tobacco control activities undertaken outside the FCTC process. For example, the EU Tobacco Products Directive (2001/37/EC), referred to as TPD1, was adopted by the EU in May 2001 for transposition into EU member states' laws by September 2002. TPD1 included provisions that set maximum tar, nicotine and carbon monoxide yields, introduced larger health warnings and banned descriptors such as "light" and "mild".

A revised TPD1, the EU Tobacco and Related Products Directive (2014/40/EU), referred to as the TPD2, was adopted in April 2014 for transposition into EU member states' law by May 2016. Provisions of the TPD2 include: larger combined pictorial and textual health warnings covering 65% of the two main pack surfaces (front and back) for cigarettes; restrictions on pack shape and size, including minimum pack sizes of 20 sticks for cigarettes and 30g for roll-your-own and make-your-own tobacco; increased ingredients reporting; "tracking and tracing" requirements; and for e-cigarettes, nicotine limits, pre-market notification, ingredients reporting and advertising bans. Among other things, the TPD2 bans the sale of tobacco products with a characterizing flavor. Menthol flavored cigarettes are exempt from the ban until May 2020.

The TPD2 also purports to leave open to EU member states the possibility of further standardizing the packaging of tobacco products and to apply its provisions in different ways. For example, it provides, among other things, that the labeling, packaging and the tobacco product itself shall not include any element or feature that suggests that a particular tobacco product has vitalizing, energetic, healing, rejuvenating, natural, organic properties or has other health or lifestyle benefits. On February 1, 2017, the French Government applied its laws transposing these provisions into French national law to prohibit the sale of all variants of Vogue cigarettes from February 2018, as well as the use of certain other tobacco brand and brand variant names.

The EU Commission is required to monitor and produce a report on the implementation and impact of the TPD2 by May 21, 2021, identifying whether further amendments to TPD2 are required.

Restrictions on Smoking in Private, Public and Work Places

The BAT Group operates in a number of markets which have in place restrictions on smoking in certain private, public and work places, including restaurants, bars and nightclubs. While these restrictions vary in scope and severity, extensive public and work place smoking bans have been enacted in markets including the United States, Canada, the United Kingdom, Spain, New Zealand and Australia. Restrictions on smoking in private have also been adopted or proposed, and typically take the form of prohibitions on smoking in cars or residential homes when children are present, or smoking within a certain distance from specified public places (such as primary schools).

Regulation of Ingredients, including Flavored Tobacco Products

A number of countries have restricted and others are seeking to restrict or ban the use of certain flavors or ingredients in cigarettes and other tobacco products, on the basis that such products are alleged to: appeal disproportionally to minors, act as a catalyst for young people taking up smoking and/or increase the addictiveness or toxicity of the relevant product.

In Canada, the manufacture and sale of cigarettes, little cigars and blunt wraps with characterizing flavors are banned. While the Canadian ingredient ban currently exempts menthol at the federal level, most Canadian provinces have adopted or are in the process of adopting menthol bans. The Canadian federal government has also recently published draft regulations that would prohibit menthol in cigarettes. In Australia, the majority of the states have banned flavors in cigarettes that give an "overtly" fruit-flavored taste and the government is currently considering further regulatory options. The TPD2 similarly bans the manufacture and sale of tobacco products with a characterizing flavor other than tobacco, subject to an exemption until May 2020 for menthol cigarettes. An ingredients ban in Brazil, which would ban the use of certain ingredients with flavoring or aromatic properties, including menthol, is not currently in force due to ongoing legal challenges. In Turkey, a ban on the use of menthol in cigarettes will apply from May 20, 2020.

Many of the above regulations are subject to ongoing legal challenges.

Further legislation on ingredients is to be expected. In particular, the EU Commission is required to prepare a report by no later than May 20, 2021 in respect of, among other things, the benefits of establishing a single list of permitted ingredients at the EU level by reference to available scientific evidence on the toxic and addictive effects of different ingredients. Similarly, the Conference of Parties to the FCTC has tasked a working group to further elaborate the partial guidelines on the regulation of the contents of tobacco products and tobacco product disclosures.

Plain and Standardized Packaging

Plain (or "standardized") packaging generally refers to a ban on the use of trademarks, logos and colors on packaging other than the use of a single color and the presentation of brand name and variant in a specified font and location(s). The presentation of individual cigarettes may be similarly restricted.

Plain packaging is particularly high on the agenda of tobacco control groups and the FCTC guidelines recommend that contracting parties consider introducing plain packaging.

To date, nine countries have adopted plain packaging legislation. The world's first plain packaging law was passed in Australia in November 2011, where plain packaging has been fully implemented since December 2012 (i.e., it has been unlawful to sell non-plain packaged products since this date in all Australian states and territories). In France, plain packaging has been fully implemented since January 2017. In the United Kingdom, plain packaging has been fully implemented since May 20, 2017. In Hungary, compliance is required immediately for new product launches, and by no later than May 2019 for existing products. In Slovenia, detailed specifications are still to be adopted, which may alter or amend the implementation timetable, but the existing legislation currently requires compliance from January 1, 2020. In Ireland, the legislation provides for a manufacturing deadline of September 30, 2017, with a 12-month sell through period for non-compliant product manufactured before this date. Plain packaging will also be implemented in Georgia from January 1, 2023, while New Zealand and Norway have only recently finalized their implementation plans.

Countries, territories and states that are currently considering adopting plain packaging legislation, include, but are not limited to, Brazil, Canada, Chile, Singapore and Sweden. Others, such as Hong Kong, are considering implementing large graphic health warnings.

Purchase: Product Display Bans at Point of Sale and Licensing Regimes

Product display restrictions at point of sale have been in place in a number of countries for several years and have been implemented both at national and state levels. Ireland was the first EU member state to introduce a point-of-sale display ban, which became effective in July 2009, with Norway, Iceland, Finland, New Zealand, Thailand, Canada, Australia, the United Kingdom and a number of other countries implementing or passing similar legislation banning tobacco displays.

A number of countries, such as Hungary, have also sought to restrict the supply of tobacco products, including through the adoption of licensing regimes limiting the number of retail outlets from which it is possible to purchase tobacco products and/or by prohibiting the sale of tobacco products within a certain distance of specified public places.

Illicit Trade

The illegal market for tobacco products is an increasingly important issue for governments and the industry across the world. Euromonitor International estimates that approximately 456 billion cigarettes per year are smuggled, manufactured illegally or counterfeited. A number of governments, regulators and organizations have or are considering adopting regulation to support anti-illicit trade activities. Among other forms, such regulation may comprise mandatory "tracking and tracing" requirements, enabling regulators to identify the point at which any seized product left the legal supply chain, security features to combat counterfeiting and inspection and authentication obligations in respect of seized product. The TPD2, for example, requires that all unit packets of tobacco are marked with a unique and irremovable identifier, which when scanned provides various information about that product's route to market.

In November 2012, the FCTC adopted the Protocol to Eliminate Illicit Trade in Tobacco Products which includes a raft of supply chain control measures, including the implementation of "tracking and tracing" technologies. To date, 29 parties have acceded, ratified, approved, accepted or confirmed the Protocol, which will come into force once 40 parties have done so.

Next Generation Products

More recently, significant debate has been generated regarding the appropriate regulation of next generation products, including regulation of the nicotine-containing liquids used in vapor products. While this nascent category has grown in size and complexity in a relatively short period of time, a consensus framework for regulation and taxation has yet to emerge.

The TPD2, for example, establishes frameworks for the regulation of novel tobacco products and e-cigarettes, introducing nicotine limits, health warnings requirements, advertising bans and pre-market notification and post-market disclosure obligations.

Conversely, some governments have intentionally banned or are seeking to ban novel tobacco products and products containing nicotine, while others would need to amend their existing legislation in order to permit their sale. For example, in Australia nicotine is classified as poison, meaning that the importation of vaping products or nicotine refill liquids is illegal in every state and territory, as is the possession and use of these products. In Canada, vaping products containing nicotine are not approved for general sale. However, at a federal level there is no regulation on non-nicotine vaping products, meaning that a number of provinces and municipalities have begun to develop their own frameworks for the sale and marketing of these products.

Even in countries where the sale of next generation products is permitted, some governments have adopted, or are seeking to adopt, bans on vaping in public places.

Following the completion of the merger, RAI's operating companies, as part of the BAT Group, will remain subject to U.S. federal, state and local laws and regulations including the FDA Tobacco Act, which currently regulates the sale of next generation products.

For further information on the U.S. regulatory environment applicable to the BAT Group's next generation products, see "*Business of RAI — Governmental Activity*".

U.S. Regulation

Following completion of the merger, the BAT Group's exposure to the impact of a wide variety of U.S. federal, state and local laws increased (by virtue of BAT's beneficial ownership of 100% of RAI's equity). For example, key elements of the FDA Tobacco Act include: filing of facility registrations, product listing, constituent testing and ingredient information; obtaining FDA clearance for all new products or product modifications; banning all characterizing artificial or natural flavors other than tobacco or menthol in cigarettes; establishing "user fees" to fund the FDA's regulation of tobacco products; increasing the health warning size on cigarette packs with the option to introduce pictorial health warnings; implementing good manufacturing practices; revising the labeling and advertising requirements for smokeless tobacco products; and requiring the study of menthol.

In respect of the latter, in 2013, the FDA issued an ANPRM, seeking comments on various issues relating to the potential regulation of menthol cigarettes. More recently, on July 28, 2017, the FDA confirmed that it would issue an ANPRM to seek public comment on the role that flavors (including menthol) in tobacco products play in attracting youth and may play in helping some smokers switch to potentially less harmful forms of nicotine delivery. As part of the same announcement, the FDA stated an intention to issue an ANPRM to seek input on the potential public health benefits and any possible adverse effects of lowering nicotine in combustible cigarettes to 'non-addictive' levels. Although it is not possible to predict whether or when the FDA will take action, the FDA, or another governmental authority, may seek to adopt regulations banning or severely restricting the use of menthol in tobacco products, the sale of menthol cigarettes or limiting nicotine yields in the United States. *See "Management's Discussion and Analysis of Financial Condition and Results of RAI — FDA Tobacco Act — Potential regulation of menthol".*

For further information on the U.S. regulatory environment applicable to the BAT Group, see "*Business of RAI — Governmental Activity*".

The BAT Group believes that as a responsible business, it can contribute through information, ideas and practical steps, to help regulators address the key issues regarding its products, including under-age access, illicit trade, product information, product design, involuntary exposure to smoke and the development of potentially less harmful products, while maintaining a competitive market that accommodates the significant percentage of adults who choose to be tobacco or nicotine consumers. The BAT Group is committed to working with national governments and multilateral organizations and welcomes opportunities to participate in good faith to achieve sensible and balanced regulation of traditional tobacco and next generation products. For information about risks related to regulation, see "*Risk Factors — Risk Factors Relating to the BAT Group and the Tobacco Industry — The BAT Group's business faces increasing tobacco control and regulation which may have an impact on its overall sales volume and profit*".

Environmental Matters

The BAT Group is subject to extensive environmental laws and regulations with respect to water and air quality, greenhouse gas emissions, solid and hazardous waste disposal and odor and noise control. The BAT Group conducts an ongoing program designed to ensure and maintain compliance with these environmental laws and regulations. The BAT Group believes that it is in material compliance with all applicable environmental laws and regulations wherever it operates. However, the BAT Group cannot predict whether future changes in environmental laws or regulations might increase the cost of operating its facilities and conducting its business. Any such changes could have adverse consequences on the BAT Group's business, financial condition and results of operations. In addition, failure to comply with these laws and regulations can result in significant fines, penalties and civil or criminal liabilities, and liability for the clean-up of contamination can, in some jurisdictions, be imposed without regard to whether the owner or operator of the property or facility knew of, or was responsible for, the release or presence of hazardous or toxic substances.

The BAT Group's Environment, Health and Safety policy, referred to as EHS policy, sets out detailed requirements for all of its operating companies, designed to achieve the BAT Group's aim of applying the best

international standards in environmental, occupational health and safety management, and to ensure that its companies give the necessary compliance activities a high priority. Unless local law is more exacting, all of the BAT Group's operating companies are expected to comply with EHS policy.

Industry and Competitive Environment

According to Euromonitor International and the BAT Group's internal estimates, the global cigarette industry sells around 5,450 billion cigarettes each year and the retail value of the global tobacco market (including cigarettes, cigars, cigarillos, smoking tobacco, smokeless tobacco and vapor products) for 2016 was estimated at $785 billion. Since 1995, the world market for cigarettes has grown, predominantly due to growth in China, which has offset the reducing volume of cigarettes in the rest of the world, especially in developed markets, such as Western Europe. Over the coming years, the BAT Group expects volumes of cigarettes outside China to continue to decline as a lower percentage of the total adult population will choose to smoke cigarettes and individual smokers will consume fewer cigarettes; these dynamics will be partially offset by the impact of population growth.

In 2016, the four biggest international manufacturers, outside of China, India and the United States, according to the BAT Group's internal estimates, were Philip Morris International with a share of the global market excluding China, India and the United States of approximately 31%, the BAT Group (excluding associates) with approximately 25%, Japan Tobacco with approximately 19% and Imperial Brands with approximately 10%, based on sales by volume. Collectively, these four players held around 41% of the global market, or approximately 84% of the market outside of China, India and the United States. According to Euromonitor International, China accounts for approximately 45% of global cigarette volume and is the world's largest cigarette market. The international tobacco companies have a very small presence in the Chinese market, where the industry is state-owned. According to Euromonitor International, India accounts for approximately 1.5% of global cigarette volume and ITC accounts for approximately 79% of India's market share. The BAT Group has an approximate 30% interest in ITC. According to Euromonitor International, the United States accounts for approximately 5% of global cigarette volume. For 2016, the RAI Group accounted for approximately 34% of the United States' cigarette market share, according to MSAi. The BAT Group has an approximate 42% interest in RAI. The global tobacco industry operates in a challenging environment. The BAT Group competes primarily on the basis of product quality, brand recognition, brand loyalty, taste, innovation, packaging, service, marketing, advertising and retail price. The size of the global cigarette market is impacted by a number of factors, including increased regulation, litigation, rising excise rates on its products and illicit trade.

Tobacco products are subject to substantial duty, excise and other taxes in most markets in which the BAT Group operates. Increases to duty, excise and other taxes affect the size of tobacco markets. Significant and sustained increases in taxes in markets where tobacco prices are already high may lead adult tobacco consumers to switch to cheaper brands. This can lead to the growth in sales of lower margin products and decreases in sales of higher margin products. Additionally, increases in tobacco taxes can lead to adult tobacco consumers rejecting legitimate tax-paid products and switching to products from illegal sources.

Trafficking of tobacco products includes the trade in counterfeit products, smuggled genuine products, including 'illicit whites' (also known as "made for smuggling brands"), and locally manufactured products on which applicable taxes are evaded. Illicit trade remains a key challenge for the legitimate tobacco industry. Illicit trade is driven by many factors, including tax-driven price increases, weak criminal penalties, poor enforcement of border controls, weak laws, corruption, loosely regulated free trade zones, a less rigorous approach to intellectual property rights protection and the use of the internet as a medium of trading. Euromonitor International estimates that approximately 456 billion cigarettes per year are smuggled, manufactured illegally or counterfeited. The BAT Group is liaising with governments and law enforcement agencies around the world to combat illicit trade. The BAT Group also undertakes a range of measures to protect its trademarks and strengthen the security of its supply chain, such as digital coding and tax verification, which help governments ensure taxes and duties are paid, and a track and trace system, which means the BAT Group can monitor its products as they move through the supply chain. The BAT Group also destroys all old machinery and spares, while cooperating with suppliers and customers to fight trafficking.

The BAT Group believes that quality and innovation will play an increasing role in delivering market share, as tobacco companies operate in a highly competitive marketplace. This involves cigarette innovations such as capsule products, additive-free products, tube filters and slims. Substantial investments have also been made in developing next generation products.

Research and Development

The BAT Group makes significant investments in research and development to deliver innovations that satisfy or anticipate consumer needs and generate growth for the business. The BAT Group has an extensive

scientific research program in a broad spectrum of scientific fields including molecular biology, toxicology and chemistry. The BAT Group has spent £446 million on research and development over the past three years (£144 million in 2016, £148 million in 2015 and £154 million in 2014), with a focus on products that could potentially reduce the risk associated with smoking conventional cigarettes.

The BAT Group is transparent about its research and development and publishes details of its research programs on its website, and the results of its studies in peer-reviewed journals.

The BAT Group's research and development function also provides guidance on the use of ingredients in the BAT Group's products to ensure its current product portfolio complies with national legislative requirements and with its own internal standards.

Capital Expenditures

Gross capital expenditures include purchases of property, plant and equipment and purchases of intangibles. The BAT Group's gross capital expenditures for 2016, 2015 and 2014 were £652 million, £591 million and £689 million, respectively, representing investment in the BAT Group's global operational infrastructure (including, but not limited to, the manufacturing network, trade marketing and IT systems). The BAT Group expects gross capital expenditures in 2017 of approximately £620 million. These 2017 expenditures do not include any expected amounts related to RAI and are primarily related to investment in the BAT Group's global operational infrastructure and are expected to be funded by operating cash flows and, where applicable, from the BAT Group's existing credit facilities.

Intellectual Property

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

The BAT Group owns the trademarks to the vast majority of the brands that it uses in its business. Generally, the BAT Group's trademarks in relation to its global drive brands and its other international brands are principally owned by the BAT Group's brand-owning companies in the United Kingdom, the United States, The Netherlands or Switzerland, and are licensed to its relevant operating companies. Other brands tend to be owned by the local BAT Group operating company.

In addition to selling brands that the BAT Group owns, the BAT Group also sells Camel, Winston and Salem branded products which are licensed to the BAT Group by Japan Tobacco with respect to cigarettes in certain markets in Latin America.

Shuang Xi (outside of the China mainland) and State Express 555 are owned by CTBAT, a joint venture between the BAT Group and CNTC.

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

- the Benson & Hedges trademark is licensed to ITC for use in respect of cigarettes and tobacco products in India;
- the Dunhill trademark is licensed to RAI for use in respect of cigarettes, cigars and tobacco products in the United States; and
- the Dunhill trademark is licensed to Rothmans, Benson & Hedges Inc. for use in respect of cigarettes and tobacco products in Canada.

As well as protecting its brand names by way of trademark registration, the BAT Group also protects its innovations by means of patents and designs in key global jurisdictions. As of December 31, 2016, the BAT Group had:

Pending Designs: 168;

Granted Designs: 1,890;

Pending Patents: 2,168; and

Granted Patents: 1,938.

Seasonality

The BAT Group's business segments are not significantly affected by seasonality, although in certain markets cigarette consumption trends rise during the summer months due to longer daylight time and tourism.

Legal Proceedings

Litigation

Product-Related Litigation

The BAT Group companies, notably B&W as well as other leading cigarette manufacturers, are defendants in a number of product liability cases. In a number of these cases, the amounts of compensatory and punitive damages sought are significant.

The litigation summary in this section addresses the litigation involving the BAT Group. For information regarding the litigation faced by the RAI Group see "*Business of RAI — Legal Proceedings*".

Indemnity

On July 30, 2004, B&W completed the B&W business combination. As a result of the B&W business combination, RJR Tobacco Company agreed to indemnify B&W and its affiliates against, among other things, certain liabilities, costs and expenses incurred by B&W or its affiliates arising out of the U.S. cigarette and tobacco business of B&W, referred to as the RJR Tobacco Indemnification.

The scope of the RJR Tobacco Indemnification includes all expenses and contingent liabilities in connection with litigation to the extent relating to or arising from B&W's U.S. tobacco business as conducted on or prior to July 30, 2004, including smoking and health tobacco litigation, whether the litigation is commenced before or after July 30, 2004, referred to as the B&W Tobacco Litigation.

Pursuant to the terms of the RJR Tobacco Indemnification, RJR Tobacco Company is liable for any possible judgments, the posting of appeal bonds or security, and all other expenses of and responsibility for managing the defense of the B&W Tobacco Litigation. RJR Tobacco Company has assumed control of the defense of the B&W Tobacco Litigation involving B&W, to which RJR Tobacco Company is also a party in most of the same cases.

Included in "— *U.S. litigation*" below are all significant cases where B&W or a UK company within the BAT Group is named as a defendant and all cases where RJR Tobacco Company is named as a defendant as a successor to B&W, referred to as the RJR Tobacco Successor Cases. The RJR Tobacco Successor Cases are covered by the RJR Tobacco Indemnification.

Following the merger, RJR Tobacco Company has become an indirect, wholly owned subsidiary of BAT and accordingly the indemnity will be between two indirect, wholly owned subsidiaries of BAT. As such the BAT Group will not benefit from an indemnification by an external party.

U.S. Litigation

The total number of U.S. tobacco product liability cases pending as of June 30, 2017 involving B&W was approximately 4,728 (compared to approximately 4,925 as of December 31, 2016). Of these, 1,928 cases are RJR Tobacco Successor Cases. As of June 30, 2017, British American Tobacco (Investments) Limited, referred to as Investments, had been served as a co-defendant in one of those cases (compared to one as of December 31, 2016). No other member of the BAT Group that is based in the United Kingdom, referred to as a UK-based Group Company, has been served as a co-defendant in any U.S. tobacco product liability case pending as of June 30, 2017. 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 totaling billions of U.S. dollars. The U.S. litigation falls into four broad categories: medical reimbursement cases; class actions; individual cases and other claims.

(a) Medical Reimbursement Case

This civil action seeks to recover amounts spent by government entities and other third-party providers on healthcare and welfare costs claimed to result from illnesses associated with smoking.

At June 30, 2017, one U.S. medical reimbursement suit was pending against B&W by an Indian tribe in an Indian tribal court in South Dakota. No other suits are pending against B&W by county or other political subdivisions of the states.

(b) Class Actions

At June 30, 2017, B&W was named as a defendant in five separate actions attempting to assert claims on behalf of classes of persons allegedly injured or financially impacted through smoking or where classes of tobacco claimants have been certified. If the classes are or remain certified, separate trials may be needed to assess individual plaintiffs' damages. Two of the five class actions against B&W allege that the use of the terms "light" and "ultralight" constitutes unfair and deceptive trade practices. Similar class action suits have been filed in a number of states against individual cigarette manufacturers and their parent corporations. It is not possible to quantify the amounts of damages at this stage.

(a) *Black* is a "lights" class action filed in November 2000, which in 2008, the Circuit Court, City of St. Louis, Missouri stayed pending U.S. Supreme Court review in *Good v Altria Group, Inc.* A status conference is scheduled for January 8, 2018.

(b) *Howard* is a "lights" class action filed in February 2000 in the Circuit Court, Madison County, Illinois, currently stayed pending resolution of *Price v Philip Morris, Inc.*

(c) *Jones* is a case filed in December 1998 in the Circuit Court, Jackson County, Missouri; the action was brought by tobacco product users and purchasers on behalf of all similarly situated Missouri consumers alleging that the plaintiffs' use of the defendants' tobacco products has caused them to become addicted to nicotine, and seeks an unspecified amount of compensatory and punitive damages. There has been limited activity in this case.

(d) *Parsons* is a case filed in February 1998 in the Circuit Court, Ohio County, West Virginia currently stayed pending final resolution of a motion brought by the plaintiffs, and because three defendants filed bankruptcy petitions.

(e) *Young* is a case filed in November 1997 in the Circuit Court, Orleans Parish, Louisiana. This Environmental Tobacco Smoke, referred to as 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 manufactured by the defendants, and who allegedly suffered injury as a result of that exposure, seeks an unspecified amount of compensatory and punitive damages, and has been stayed since 2004.

Engle Class Action (Florida): In 2000, three class representatives in the *Engle* class action were awarded a total of $12.7 million in compensatory damages and punitive damages against B&W were assessed at $17.6 billion. This decision was appealed and ultimately resulted in the Florida Supreme Court, in July 2006, decertifying the class and allowing judgments entered for only two of the three *Engle* class representatives to stand and setting aside the punitive damage award. Putative *Engle* class members were permitted to file individual lawsuits against the *Engle* defendants within one year of the Florida Supreme Court's decision (subsequently extended to January 11, 2008).

As of June 30, 2017, B&W had been served in approximately 24 *Engle* Progeny cases in both state and federal courts in Florida. These cases include approximately 82 plaintiffs. RJR Tobacco Company, as a successor to B&W, is named in approximately 1,918 *Engle* Progeny cases. These cases include approximately 2,483 plaintiffs. For more information on the B&W litigation, see "*Business of RAI — Legal Proceedings*".

As of June 30, 2017, approximately 114 additional *Engle* Progeny trials naming RJR Tobacco Company as successor to B&W have proceeded to verdict. Of these 114 trials, approximately 66 resulted in plaintiffs' verdicts. As of June 30, 2017, total damages awarded against RJR Tobacco Company as successor to B&W in final judgments in these cases are $319,464,730. This number comprises approximately $161,427,927 in compensatory damages and $158,036,803 in punitive damages. As of June 30, 2017, RJR Tobacco Company had appealed 54 of these 66 adverse judgments and still had time to appeal 12 of these 66 adverse judgments. Out of the 54 adverse judgments appealed by RJR Tobacco Company, 24 appeals remained undecided and 27 appeals were decided and/or closed. In nine of the appeals that were decided, the appellate court affirmed the liability finding but vacated the damages award and remanded the matter to the trial court. In five of the appeals that were decided, the appellate court reversed the final judgment and remanded the matter to the trial court for a new trial on all issues. Two appeals were voluntarily dismissed. RJR Tobacco Company has paid damages to the plaintiffs in 16 cases that are now closed.

The Florida legislature applies a $200 million bond cap to all *Engle* Progeny cases in the aggregate. Individual bond caps for any given *Engle* Progeny case varies depending on the number of judgments in effect at a given time but never exceeds $5 million per case for appeals within the Florida state court system.

Judicial attempts by several plaintiffs in the *Engle* Progeny cases to challenge the bond cap as violating the Florida Constitution have failed and bills have been introduced in the Florida legislature to modify or eliminate the *Engle* Progeny bond cap.

(c) Individual Cases

Approximately 2,794 cases were pending against B&W as of June 30, 2017 (compared to 2,889 as of December 31, 2016), 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: (1) 2,345 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; (2) 393 are cases brought in consolidated proceedings in West Virginia, where the first phase of the trial began on April 15, 2013, and on May 15, 2013 the jury returned a verdict for defendants on all but one of plaintiffs' claims and the judgment resulting from the verdict was affirmed on appeal; (3) 24 are *Engle* Progeny cases that have been filed directly against B&W; and (4) 32 are cases filed by other individuals.

In addition to the 1,918 *Engle* Progeny cases, which name RJR Tobacco Company as successor to B&W, there are 10 cases filed by other individuals naming RJR Tobacco Company as successor to B&W.

(d) UK-Based Group Companies

As of June 30, 2017, Investments has been served in one dormant individual action in the United States (*Perry*) in which there has been no activity since 1998 following the plaintiff's death in 1997.

In December 2016, BAT received a complaint in an individual personal injury action pending in state court in Seattle, Washington (*Ratcliff*). The plaintiff asserts various claims, including state law product liability, fraud and statutory claims, against multiple defendants, including BAT, and alleges that she developed malignant mesothelioma from, amongst other things, her exposure to asbestos found in certain talc-containing cosmetic products and powders. BAT filed a motion to dismiss for improper service and lack of personal jurisdiction on February 8, 2017. On May 30, 2017, the court entered a stipulated order of dismissal that dismissed the Company from the Washington action without prejudice. In March 2017, the same plaintiff (Ratcliff) filed another case, in federal court in North Carolina, against multiple defendants, including BAT, alleging essentially the same facts. On July 17, 2017, the court entered an order which granted the joint motion of plaintiff and the Company to dismiss the Company from the North Carolina action without prejudice. This case is now at an end for BAT.

Non-U.S. Litigation

As of June 30, 2017, active product liability claims against the BAT Group's companies existed in 15 markets outside the United States. The only markets with more than five claims were Argentina, Brazil, Canada, Chile, Italy and Nigeria. Medical reimbursement actions are being brought in Angola, Argentina, Brazil, Canada, Nigeria and South Korea. Class actions are being brought in Brazil, Canada, Italy and Venezuela.

(a) Medical reimbursement cases

Angola

In or about November 2016, BAT Angola affiliate Sociedade Unificada de Tabacos de Angola, referred to as SUT, was served with a collective action filed in the Provincial Court of Luanda, 2nd Civil Section, by the consumer association Associação Angolana dos Direitos do Consumidor, referred to as AADIC. The lawsuit seeks damages allegedly incurred by the Angolan Instituto Nacional do Controlo do Cancro, referred to as INCC, for the cost of treating tobacco-related disease, non-material damages allegedly suffered by certain individual smokers on the rolls of INCC, and the mandating of certain cigarette package warnings. SUT filed its answer to the claim on or about December 5, 2016. The case remains pending.

Argentina

In 2007, the non-governmental organization the Argentina Tort Law Association, referred to as ATLA, and Emma Mendoza Voguet brought a reimbursement action against Nobleza Piccardo S.A.I.C.y.F., referred to as Nobleza, and Massalín Particulares. The case is being heard in the Contentious Administrative Court and is currently at the evidentiary stage.

Brazil

In August 2007, the São Paulo Public Prosecutor's Office filed a medical reimbursement claim against Souza Cruz S.A., a wholly owned subsidiary of BAT, referred to as Souza Cruz. A similar claim was lodged against Philip Morris Brasil Indústria e Comércio Ltda. On October 4, 2011, the Court dismissed the action against Souza Cruz, with a judgment on the merits. The plaintiffs' appeal to the Court of Appeal failed by unanimous vote (3 to 0). The Public Prosecutor's Office has since filed a Special Appeal to the Superior Court of Justice.

Canada

Following the implementation of legislation enabling provincial governments to recover healthcare costs directly from tobacco manufacturers, ten actions for recovery of healthcare costs arising from the treatment of smoking and health-related diseases have been brought. These proceedings name various BAT Group companies as defendants. Among the defendants are various BAT Group companies, including BAT, Investments, B.A.T Industries p.l.c., Carreras Rothmans Limited, collectively referred to as the UK Companies, and Imperial Tobacco Canada Limited, referred to as Imperial, the BAT Group's operating company in Canada, and actions are proceeding in British Columbia, New Brunswick, Newfoundland and Labrador, Ontario, Quebec, Manitoba, Alberta, Saskatchewan, Nova Scotia and Prince Edward Island, referred to as PEI. The enabling legislation is in force in all ten provinces. In addition, legislation has received Royal Assent in two of the three territories in Canada, but has yet to be proclaimed into force. In Quebec, three Canadian manufacturers, including Imperial, challenged the enabling legislation. This challenge was dismissed.

The government of British Columbia brought a claim in 2001 pursuant to the provisions of the Tobacco Damages and Health Care Costs Recovery Act 2000 against domestic and foreign manufacturers, seeking to recover the plaintiff's costs of smoking-related healthcare benefits. Imperial, Investments, B.A.T Industries p.l.c. and other former Rothmans Group companies are named as defendants. The underlying healthcare reimbursement action remains at a preliminary case management stage. The federal government is seeking Cdn$5 million jointly from all the defendants in respect of costs. On February 13, 2017 the province delivered an expert report dated October 2016, quantifying its damages in the amount of Cdn$118 billion. No hearing date has been set.

The government of New Brunswick has brought a healthcare reimbursement claim in June 2006 against domestic and foreign tobacco manufacturers, pursuant to the provisions of the Tobacco Damages and Health Care Costs Recovery Act 2006 enacted in that province. The UK Companies and Imperial have all been named as defendants. Both Imperial and the UK Companies have now filed their defenses and document production is underway and discoveries are substantially complete. Damages have recently been calculated by the province as in the range of Cdn$25-$60 billion from 1954 to 2060. Following a motion to set a trial date, the court has ordered that trial commence on November 4, 2019.

The government of the Province of Ontario has filed a healthcare reimbursement claim against domestic and foreign tobacco manufacturers, pursuant to the provisions of the Tobacco Damages and Health Care Costs Recovery Act 2009 enacted in that province. Both Imperial and the UK Companies have all been named as defendants. This case is at an early case management stage and Imperial and the UK Companies have filed defenses. Document production began on May 31, 2017. The province has stated its claim to be worth Cdn$50 billion. No trial date has been set.

The government of the Province of Newfoundland and Labrador filed a healthcare reimbursement claim in February 2011 against domestic and foreign tobacco manufacturers, pursuant to the provisions of the Tobacco Damages and Health Care Costs Recovery Act 2006 enacted in that province. Imperial and the UK Companies have all been named as defendants. The case is now under case management and Imperial and the UK Companies have filed defenses. Damages have not been quantified by the province. No trial date has been set.

The government of the Province of Saskatchewan filed a healthcare reimbursement claim in June 2012 against domestic and foreign tobacco manufacturers, pursuant to the provisions of the Tobacco Damages and Health Care Costs Recovery Act 2012 enacted in that province. Imperial and the UK Companies have all been named as defendants. This case is at an early case management stage. A standstill agreement was negotiated under which defenses were filed by February 27, 2015 and the matter will remain in abeyance until document production begins in September 2017. Damages have not been quantified by the province. No trial date has been set.

The government of the Province of Manitoba filed a healthcare reimbursement claim in May 2012 against domestic and foreign tobacco manufacturers, pursuant to the provisions of the Tobacco Damages Health Care Costs Recovery Act 2006 enacted in that province. Imperial and the UK Companies have all been named as defendants. This case is at an early case management stage. A standstill agreement has been negotiated, under which defenses were filed. Pursuant to that agreement, document production began in June 2017. Damages have not been quantified by the province. No trial date has been set.

The government of the Province of Alberta filed a healthcare reimbursement claim in June 2012 against domestic and foreign tobacco manufacturers, pursuant to the provisions of the Crown's Right of Recovery Act 2009 enacted in that province. Imperial and the UK Companies have all been named as defendants. This case is at an early case management stage and Imperial and the UK Companies have filed defenses. The province has stated its claim to be worth Cdn$10 billion. No trial date has been set.

The government of the Province of Quebec filed a healthcare reimbursement claim in June 2012 against domestic and foreign tobacco manufacturers, pursuant to the provisions of the Tobacco Related Damages and Health Care Costs Recovery Act 2005 enacted in that province. Imperial, Investments, B.A.T Industries p.l.c., and Carreras Rothmans Limited have been named as defendants. Imperial and the other Canadian manufacturers' constitutional challenge to the Quebec Medicaid Legislation was unsuccessful at both first instance and on appeal. Another manufacturer sought leave to appeal to the Supreme Court of Canada. Leave was refused on May 5, 2016. This case is at an early case management stage. Defenses have been filed. Motions over admissibility of documents and damages discovery have been filed but not heard. On July 7, 2017, the province began production of documents. The province is seeking Cdn$60 billion. No trial date has been set.

The government of the Province of PEI filed a healthcare reimbursement claim in September 2012 against domestic and foreign tobacco manufacturers, pursuant to the provisions of the Tobacco Damages and Health Care Costs Recovery Act 2009 enacted in that province. Imperial and the UK Companies have all been named as defendants. This case is at an early case management stage. A standstill agreement has been negotiated. Defenses were filed in February 2015 and the next step will be document production, which is expected to commence on or before September 1, 2017. Damages have not been quantified by the province. No trial date has been set.

The government of the Province of Nova Scotia filed a healthcare reimbursement claim in January 2015 against tobacco industry defendants pursuant to the provisions of the Tobacco Health Care Costs Recovery Act 2005 enacted in that province. Imperial and the UK Companies have all been named as defendants. This case is at an early case management stage. A standstill agreement has been negotiated. Defenses were filed in July 2015 and the next step will be document production, which is expected to commence on or before September 1, 2017. Damages have not been quantified by the province. No trial date has been set.

Nigeria

As of June 30, 2017, six medical reimbursement actions filed by the federal government and five Nigerian states (Lagos, Kano, Gombe, Oyo, Ogun) were pending in the Nigerian courts. British American Tobacco (Nigeria) Limited, referred to as BAT Nigeria, BAT and Investments have been named as defendants in each of the cases. The plaintiffs in the six cases seek a total of approximately 11 trillion Nigerian naira (roughly £27 billion at current exchange rates) in damages, including special, anticipatory and punitive damages, restitution and disgorgement of profits, as well as declaratory and injunctive relief.

The federal action was filed on November 6, 2007 in the Federal High Court, and the five state actions were commenced in their respective High Courts on May 9, 2007 (Kano), May 30, 2007, (Oyo), March 13, 2008 (Lagos), October 17, 2008 (Gombe), and February 26, 2008 (Ogun). The suits claim that the state and federal government plaintiffs incurred costs related to the treatment of smoking-related illnesses resulting from allegedly tortious conduct by the defendants in the manufacture, marketing, and sale of tobacco products in Nigeria, and assert that the plaintiffs are entitled to reimbursement for such costs. The plaintiffs assert causes of action for negligence, negligent design, fraud and deceit, fraudulent concealment, breach of express and implied warranty, public nuisance, conspiracy, strict liability, indemnity, restitution, unjust enrichment, voluntary assumption of a special undertaking, and performance of another's duty to the public.

BAT and Investments have made a number of challenges to the jurisdiction of the Nigerian courts. Such challenges are still pending (on appeal) against the federal government and the states of Lagos, Kano, Gombe and Ogun. The underlying cases are stayed or adjourned pending the final outcome of these jurisdictional challenges. In the state of Oyo, on November 13, 2015 and February 24, 2017 respectively, BAT's and Investments' jurisdictional challenges were successful in the Court of Appeal and the issuance of the writ of summons was set aside.

South Korea

In April 2014, Korea's National Health Insurance Service, referred to as NHIS, filed a healthcare recoupment action against KT&G, a Korean tobacco company, PM Korea and BAT Korea (including BAT Korea Manufacturing). The NHIS is seeking damages of roughly 54 billion Korean Won (roughly £37 million) in respect of healthcare costs allegedly incurred by the NHIS treating patients with lung (small cell and squamous cell) and laryngeal (squamous cell) cancer between 2003 and 2012. Court hearings in the case, which constitute the trial, commenced in September 2014 and remain ongoing.

(b) Class actions

Brazil

As of March 31, 2017, there were two class actions being brought in Brazil. One is also a medical reimbursement claim (São Paulo Public Prosecutor's Office), and is therefore discussed above.

In 1995, the Associação de Defesa da Saúde do Fumante, referred to as ADESF, class action was filed against Souza Cruz and Philip Morris in the São Paulo Lower Civil Court alleging that the defendants are liable to a class of smokers and former smokers for failing to warn of cigarette addiction. The case was stayed in 2004 pending the defendants' appeal from a decision issued by the Lower Civil Court that held that the defendants had not met their burden of proving that cigarette smoking was not addictive or harmful to health.

On November 12, 2008, the São Paulo Court of Appeals overturned the lower court's unfavorable decision of 2004, returning the case to the lower court for production of evidence and a new judgment. Following production of evidence, on May 16, 2011, the lower court granted Souza Cruz's motion to dismiss the action in its entirety on the merits. The plaintiffs' appeal to the São Paulo Court of Appeals was unsuccessful. Plaintiffs then filed a Special Appeal to the Superior Court of Justice, which was rejected under procedural grounds on February 20, 2017. Plaintiffs filed an appeal of the rejection in the Superior Court of Justice on March 15, 2017.

Canada

There are 11 class actions being brought in Canada against, among others, members of the BAT Group.

Knight is a 'lights' class action: The Supreme Court of British Columbia certified a class of all consumers who purchased Imperial cigarettes in British Columbia bearing 'light' or 'mild' descriptors since 1974. The plaintiff is seeking compensation for amounts spent on 'light and mild' products and a disgorgement of profits from Imperial on the basis that the marketing of light and mild cigarettes was deceptive because it conveyed a false and misleading message that those cigarettes are less harmful than regular cigarettes.

On appeal, the appellate court confirmed the certification of the class, but limited any financial liability, if proven, to 1997 onward. Imperial's third-party claim against the federal government was dismissed by the Supreme Court of Canada. The federal government is seeking a parallel cost order of Cdn$5 million from Imperial. After being dormant for several years, the plaintiff delivered a Notice of Intention to Proceed, and Imperial delivered an application to dismiss the action for delay. The application was heard on June 23, 2017 and a decision is under reserve.

In December, 2009, Imperial was served with a proposed class action filed by Ontario tobacco farmers and the Ontario Flue-Cured Tobacco Growers' Marketing Board. The plaintiffs allege that Imperial and the Canadian subsidiaries of Philip Morris International and Japan Tobacco International failed to pay the agreed domestic contract price to the tobacco leaf growers used in products manufactured for the export market and ultimately smuggled back into Canada. The plaintiffs seek damages in the amount of Cdn$50 million. Various preliminary challenges have been heard, the last being a motion for summary judgment on a limitation period. The motion was dismissed and ultimately, leave to appeal to the Ontario Court of Appeal was dismissed in November 2016. A certification hearing has yet to be scheduled.

There are currently two class actions in Quebec. On February 21, 2005, the Quebec Superior Court granted certification in two class actions against Imperial and two other domestic manufacturers, which have a combined value of Cdn$21 billion plus interest and costs. The Court certified two classes, which include residents of Quebec who suffered from lung, throat and laryngeal cancer or emphysema as of November 1998 or developed these diseases thereafter and who smoked a minimum of 15 cigarettes a day for at least five years, and residents who were addicted to nicotine at the time the proceedings were filed and who have since remained addicted. Judgment was rendered on May 27, 2015. The plaintiffs were awarded moral and punitive damages and interest against Imperial and the Canadian subsidiaries of Philip Morris International and Japan Tobacco International in the amount of Cdn$15.6 billion, of which Imperial's share is Cdn$10.4 billion. An appeal of the judgment was filed on June 26, 2015. The Court also awarded provisional execution pending appeal of Cdn$1.131 billion, of which Imperial's share was approximately Cdn$742 million, which order was subsequently overturned by the Court of Appeal. Following the cancellation of the order for provisional execution, the Plaintiffs filed a motion against Imperial and one other manufacturer seeking security in the amount of Cdn$5 billion to guarantee, in whole or in part, the payment of costs of the appeal and the judgment. On October 27, 2015, the Court of Appeal ordered the parties to post security in the amount of Cdn$984 million. Imperial's share, Cdn$758 million, was paid in seven equal quarterly instalments (of just over Cdn$108 million) between December 31, 2015 and June 30, 2017. Imperial filed its Factum on Appeal on December 11, 2015 and the appeal was heard in November 2016. A decision is under reserve.

In June 2009, four new smoking and health class actions were filed in Nova Scotia (*Semple*), Manitoba (*Kunta*), Saskatchewan (*Adams*) and Alberta (*Dorion*), against Canadian and foreign manufacturers and foreign companies, including the UK Companies and Imperial. In Saskatchewan, BAT and Carreras Rothmans Limited have been released from the action. No date has been set for the certification motion hearing. There are service issues in relation to Imperial and the UK Companies in Alberta and in relation to the UK Companies in Manitoba.

In July 2010, two further smoking and health class actions in British Columbia were served on Imperial and the UK Companies. The Bourassa claim is allegedly on behalf of all individuals who have suffered chronic respiratory disease and the McDermid claim proposes a class based on heart disease. Both claims state that they have been brought on behalf of those who have "smoked a minimum of 25,000 cigarettes". The UK Companies and Imperial objected to jurisdiction. Subsequently, BAT and Carreras Rothmans Limited were released from Bourassa and McDermid. Imperial, B.A.T Industries p.l.c. and Investments remain as defendants in both actions. No certification motion hearing date has been set. The Plaintiffs were due to deliver certification motion materials by January 31, 2015, but have not yet done so. Once the materials are delivered, the motions regarding jurisdiction/abuse of process matters will be dealt with.

In June 2012, a new smoking and health class action was filed in Ontario (*Jacklin*) against the domestic manufacturers and foreign companies, including Imperial and the UK Companies. Imperial was served on November 20, 2012, and the UK Companies were served on November 30, 2012. The claim is presently in abeyance.

Italy

In or about June 2010, BAT Italia was served with a class action filed in the Civil Court of Rome by the consumer association, Codacons, and three class representatives. The plaintiffs primarily asserted addiction-related claims. The class action lawsuit was rejected at the first instance (Civil Court of Rome) and appellate (Rome Court of Appeal) court levels. In July 2012, Codacons filed an appeal before the Italian Supreme Court. At a hearing on January 21, 2015, the Public Prosecutor's Office agreed that the appeal should be rejected, and the Supreme Court reserved its decision. On February 1, 2017, the Supreme Court rejected Codacons' appeal. Codacons' deadline to file a motion for rehearing before the Supreme Court falls on or about March 5, 2018.

Venezuela

In April 2008, the Venezuelan Federation of Associations of Users and Consumers, referred to as FEVACU, and Wolfang Cardozo Espinel and Giorgio Di Muro Di Nunno, acting as individuals, filed a class action against the Venezuelan government. The class action seeks regulatory controls on tobacco and recovery of medical expenses for future expenses of treating smoking-related illnesses in Venezuela. Both C.A Cigarrera Bigott Sucs. and ASUELECTRIC, represented by its president Giorgio Di Muro Di Nunno (who had previously filed as an individual), have been admitted as third-parties by the Constitutional Chamber of the Supreme Court of Justice. A hearing date for the action is yet to be scheduled. On April 25, 2017, Cigarrera Bigott requested the Court to declare the lapsing of the class action due to no proceedings taking place in the case in over a year. A ruling on the matter is yet to be issued.

(c) Individual personal injury claims

As of June 30, 2017, the jurisdictions with the most number of active individual cases against BAT Group companies were, in descending order: Brazil (79), Italy (25), Chile (8), Argentina (8), Canada (6) and Ireland (2) There were a further five jurisdictions with one active case only.

Non-Tobacco Related Litigation

Reynolds American Inc. / Lorillard, Inc. Shareholder Litigation

In connection with the Lorillard merger, BAT executed a Share Repurchase Agreement to acquire a sufficient number of RAI's shares to maintain its approximately 42% equity stake in RAI after the merger.

On August 8, 2014, BAT was named as a defendant in an action in state court in North Carolina stemming from the announcement of the Lorillard merger. The action was brought on behalf of a putative class of RAI's shareholders alleging that BAT is a controlling shareholder of RAI and breached its fiduciary duty to the other RAI shareholders in connection with the Lorillard Transaction.

On August 28, 2015, the court dismissed all claims against BAT. Among other things, the court found that the plaintiff had not properly alleged that BAT was a controlling shareholder of RAI and therefore that BAT did not owe a fiduciary duty to RAI's other shareholders. On December 20, 2016, the North Carolina Court of Appeals reversed the trial court's judgment with respect to the claims against BAT, finding the allegations that the Company was a controlling shareholder and breached its fiduciary duty to be sufficient to warrant further proceedings for the plaintiff to attempt to prove those allegations with evidence. On January 4, 2017, the Company moved to have the North Carolina Court of Appeals rehear the case *en banc*, and that motion was denied on February 2, 2017. On February 17, 2017, BAT filed a petition for discretionary review with the North Carolina Supreme Court, which the plaintiff opposed on February 27, 2017. On June 9, 2017, the North Carolina

Supreme Court allowed the Company's petition for discretionary review. Briefing in the North Carolina Supreme Court is scheduled to conclude in September 2017. A date for oral argument has not yet been set.

Khosravi

In January 2014, an individual named Mehdi Khosravi issued a claim in the English High Court against BAT, as well as Al Aqili Trading LLC, Mohammed Saleh Al Aqili and Mohammed Saeed Mohamed Al Aqili, referred to as the Al Aqili Defendants. In September 2015, the claimant amended his claim to join B.A.T. (U.K. and Export) Limited and B.A.T. Pars Company as defendants and served the claim on BAT and B.A.T. (U.K. and Export) Limited, referred to as the BAT UK Defendants. B.A.T. Pars Company has not been served with the claim and therefore is currently not an active party to the proceedings.

The claimant sought damages of up to £1.5 billion for alleged personal injuries and economic loss which, he alleged, were caused by the Al Aqili Defendants acting as agents for the BAT UK Defendants and/ or for which the BAT UK Defendants were vicariously liable. On January 28, 2016, the judge dismissed the case against the BAT UK Defendants and ordered that the claimant should pay their legal costs. The claimant then applied for permission to appeal the decision. Permission to appeal was refused on paper on November 22, 2016 and at an oral hearing on July 4, 2017. This case is now closed.

Georgian Competition Claim

In July 2016, OGT Ltd, referred to as OGT, a Georgian tobacco manufacturer, filed a claim in the Tbilisi City Court against British American Tobacco Georgia Limited, referred to as BAT Georgia, and BAT Georgia's Representative Office in Tbilisi, as well as T&R Distribution Ltd, BAT Georgia's exclusive distributor in Georgia, alleging anti-competitive practices on behalf of the defendants. In January 2017, OGT filed a revised pleading claiming damages of approximately $101 million. BAT Georgia and its Representative Office filed their revised defense again denying the allegations and a counterclaim in January 2017. On February 10, 2017, judgment was entered against BAT Georgia for $100,537,172, BAT Georgia's counterclaim was dismissed and the Georgian court ordered that it would determine the price at which BAT Georgia's brands would be sold. The judgment was appealed. On June 8, 2017 the Tbilisi Court of Appeals overturned the judgment against BAT Georgia in all respects save it upheld the dismissal of BAT Georgia's counterclaim. It is open to OGT to seek to appeal to the Georgian Supreme Court.

Fox River

Background to Environmental Liabilities Arising out of Contamination of the Fox River

In Wisconsin, the authorities have identified potentially responsible parties, referred to as PRPs, to fund the clean-up of river sediments in the lower Fox River. The pollution was caused by discharges of Polychlorinated Biphenyls, referred to as PCBs, from paper mills and other facilities operating close to the river. Among the PRPs is NCR Corporation, referred to as NCR.

In NCR's Form 10-K Annual Report for the year ended December 31 2014, the total clean-up costs for the Fox River are estimated at $825 million. This estimate is subject to uncertainties and does not include natural resource damages, referred to as NRDs. Total NRDs may range from $0 to $246 million, although NCR now only retains residual exposure to NRDs in the form of claims by other PRPs as the U.S. Government has withdrawn its direct claims for NRDs against NCR.

B.A.T Industries p.l.c.'s involvement with the environmental liabilities arises out of indemnity arrangements which it became party to due to a series of transactions that took place from the late 1970s onwards and subsequent litigation brought by NCR against B.A.T Industries p.l.c. and Appvion Inc, referred to as Appvion (a former BAT Group subsidiary) in relation to those arrangements which was ultimately settled. U.S. authorities have never identified B.A.T Industries p.l.c. as a PRP.

There has been a substantial amount of litigation in the United States involving NCR and Appvion regarding the responsibility for the costs of the clean-up operations. The current position can be summarized as follows:

As regards the upper portion of the Fox River, the District Court has ruled that NCR is liable in respect of this portion of the river because the river constitutes one site. That notwithstanding, the District Court has since indicated that NCR had no liability for that portion of the river because it did not discharge PCBs there.

As regards the mid and lower portions of the Fox River:

- As a result of the U.S. Government enforcement proceedings against it, NCR has been held jointly and severally liable in respect of the mid and lower portions of the Fox River. Consequently, NCR is responsible for the costs of cleaning up of the mid and lower portions of the river, subject to any right of contribution it has against other PRPs and any right to appeal.

- Appvion on the other hand has been found not liable in respect of the clean-up (including NRDs) in the U.S. Government enforcement proceedings.
- The remaining element of the U.S. Government enforcement proceedings (the U.S. Government's claim against NCR to recover costs it has incurred in relation to the clean-up) was scheduled to go to trial in May 2017 but those proceedings have now been stayed (as explained below).
- NCR's claims for contribution against the other PRPs in respect of the costs it has incurred in relation to the clean-up (and those PRPs' cross-claims for contribution against NCR to recover the costs they have incurred and NRDs they have had to pay) were scheduled to go to trial in May 2017 but those proceedings have also been stayed (as explained below).
- Appvion's claims to recover from PRPs other than NCR monies that it spent on the clean-up prior to being held not liable were also due to go to trial at the same time but have been stayed as well.

Recent Settlements

On December 22, 2016, NCR and Appvion entered into a settlement agreement with certain of the other PRPs pursuant to which those PRPs released their contribution claims against NCR and Appvion released its claims against those PRPs.

On January 17, 2017, NCR and Appvion entered into a Consent Decree (a form of settlement agreement) with the U.S. Government to resolve how the remaining clean-up will be funded and to resolve all outstanding claims between them.

The Consent Decree requires approval from the District Court in Wisconsin in order to be made final. The public had until February 22, 2017 to comment on the proposal, after which the Court will make a determination. It is anticipated that the Court approval process will take several months. The U.S. Government enforcement action and the PRPs' contribution claims have been stayed pending the outcome of the Court approval process.

If the Consent Decree is approved its principal effects will, in summary, be as follows:

- NCR will perform and fund all of the remaining Fox River remediation work by itself.
- the U.S. Government enforcement proceedings will be settled, with NCR having no liability to meet the U.S. Government's claim for costs it has incurred in relation to the clean-up to date and only a secondary responsibility to meet certain future costs. NCR will have no liability to the U.S. Government for NRDs.
- NCR will cease to pursue its contribution claims against the other PRPs and in return will receive contribution protection which means that the other PRPs will not be able to pursue their contribution claims against NCR. NCR will, however, have the right to reinstate its contribution claims if the other PRPs decide to continue to pursue certain contractual claims against NCR.
- Appvion will also cease to pursue its claims against the other PRPs to recover monies that it has spent on the clean-up and in return will receive contribution protection. Appvion will, however, have the right to reinstate its claims if the other PRPs decide to continue to pursue certain claims against Appvion.

B.A.T Industries p.l.c.'s Involvement with Environmental Liabilities Arising out of the Contamination of the Fox River

NCR has taken the position that, under the terms of the Settlement Agreement between it, Appvion and B.A.T Industries p.l.c. and a 2005 arbitration award, B.A.T Industries p.l.c. and Appvion generally had a joint and several obligation to bear 60% of the Fox River environmental remediation costs imposed on NCR and of any amounts NCR has to pay in respect of other PRPs' contribution claims.

Until May 2012, Appvion and the AWA Entities paid the 60% share of the clean-up costs and B.A.T Industries p.l.c. was never required to contribute. Around that time Appvion refused to continue to pay clean-up costs, leading to NCR demanding that B.A.T Industries p.l.c. pay a 60% share. B.A.T Industries p.l.c. commenced proceedings against Windward and Appvion in December 2011 seeking indemnification in respect of any liability it might have to NCR, referred to as the English Indemnity Proceedings, pursuant to a 1990 de-merger agreement between those parties.

Funding Agreement of September 30, 2014

On September 30, 2014, B.A.T Industries p.l.c. entered into the Funding Agreement with Windward, Appvion, NCR and BTI 2014 LLC (a wholly owned subsidiary of B.A.T Industries p.l.c.). Pursuant to the

Funding Agreement, the English Indemnity Proceedings and a counterclaim Appvion had brought in those proceedings, as well as an NCR-Appvion arbitration concerning Appvion's indemnity to NCR, were discontinued as part of an overall agreement between the parties providing a framework through which they would together fund the ongoing costs of the Fox River clean-up. Under the agreement, NCR has agreed to accept funding by B.A.T Industries p.l.c. at the lower level of 50% of the ongoing clean-up related costs of the Fox River (rather than the 60% referenced above; this remains subject to an ability to litigate the extent to which a further 10% of the costs ought to be allocated at a later stage). In addition, Windward has contributed $10 million of funding and Appvion has contributed $25 million for the Fox River and Appvion has agreed to contribute $25 million for the Kalamazoo River (see further below).

The parties also agreed to cooperate in order to maximize recoveries from certain claims made against third parties, including (i) a claim commenced by Windward in the High Court of England & Wales (the High Court) against Sequana and the former Windward directors, referred to as the Windward Dividend Claim. That claim was assigned to BTI under the Funding Agreement, and relates to dividend payments made by Windward to Sequana of around €443 million in 2008 and €135 million in 2009, referred to as the Dividend Payments, and (ii) a claim commenced by B.A.T Industries p.l.c. directly against Sequana to recover the value of the Dividend Payments alleging that the dividends were paid for the purpose of putting assets beyond the reach of Windward's creditors (including B.A.T Industries p.l.c.), referred to as the BAT section 423 Claim.

A trial of the Windward Dividend Claim and the BAT section 423 Claim took place before the English High Court between February and April 2016. Judgment was handed down by the High Court on July 11, 2016. The Court held that the 2009 Dividend Payment of €135 million was a transaction at an undervalue made with the intention of putting assets beyond the reach of B.A.T Industries p.l.c. or of otherwise prejudicing B.A.T Industries p.l.c.'s interests. It therefore contravened Section 423 of the Insolvency Act. The Court dismissed the Windward Dividend Claim.

BTI 2014 LLC sought permission to appeal in respect of the Judge's findings in relation to the Windward Dividend Claim. Sequana sought permission to appeal the Judge's findings in relation to the BAT section 423 Claim. On January 13, 2017, January 16, 2017 and February 3, 2017, further hearings took place to determine the precise form of relief to be awarded to B.A.T Industries p.l.c. and to hear the parties' applications for permission to appeal. Judgment was handed down on February 10, 2017. In respect of relief, the Court ordered that Sequana must pay BTI 2014 LLC an amount up to the full value of the 2009 Dividend plus interest (which equates to around $185 million). This figure is subject to increase as interest is continuing to accrue. Sequana must make an initial payment of around $138.4 million and further payments going forward as and when B.A.T Industries p.l.c. makes payments in respect of clean-up costs. In respect of appeals, the Court granted BTI 2014 LLC and Sequana permission to appeal. The appeal hearing is expected to take place during 2018. The Court also granted Sequana a stay in respect of the above payments it has been ordered to make pending Sequana's appeal being resolved. On February 15, 2017 Sequana entered into a process in France seeking court protection (the "Sauvegarde").

BTI 2014 LLC has brought claims against certain of Windward's former advisors, including Windward's auditors at the time of the dividend payments, PricewaterhouseCoopers LLP (which claims were also assigned to BTI 2014 LLC under the Funding Agreement). Those claims are currently subject to a stay.

The sums B.A.T Industries p.l.c. has agreed to pay under the Funding Agreement are subject to ongoing adjustment, as clean-up costs can only be estimated in advance of the work being carried out and as certain sums payable are the subject of ongoing U.S. litigation. In 2016, B.A.T Industries p.l.c. paid £6 million in respect of clean-up costs and is potentially liable for a further £159 million in future clean-up costs. As of 2011, B.A.T Industries p.l.c. has had a provision in place. This provision is currently £163 million which represents the current best estimate of its exposure.

Kalamazoo River

B.A.T Industries p.l.c. is aware that NCR is also being pursued by Georgia-Pacific, as the owner of a facility on the Kalamazoo River in Michigan which released PCBs into that river. Georgia-Pacific has been designated as a PRP in respect of the river.

Georgia-Pacific contends that NCR is responsible for, or should contribute to, the clean-up costs, because: (1) a predecessor to NCR's Appleton Papers Division sold "broke" containing PCBs to Georgia-Pacific or others for recycling; (2) NCR itself sold paper containing PCBs to Georgia-Pacific or others for recycling; and/or (3) NCR is liable for sales to Georgia-Pacific or others of PCB-containing broke by Mead Corporation, which, like the predecessor to NCR's Appleton Papers Division, coated paper with the PCB containing emulsion manufactured by NCR.

A full trial on liability took place in February 2013. On September 26, 2013, the Michigan Court held that NCR was liable as a PRP on the basis that broke sales constituted an arrangement for the disposal of hazardous material for the purposes of CERCLA. The decision was based on NCR's knowledge of the hazards of PCBs from at least 1969, but the Court did not specify directly the entity or entities whose broke sales form the basis of NCR's liability. NCR will have the ability to appeal the ruling once a final judgment has been entered or it has been otherwise certified for appeal.

The second phase of the Kalamazoo trial to determine the apportionment of liability amongst NCR, Georgia-Pacific and the other PRPs (International Paper Company and Weyerhaeuser Company) took place between September and December 2015. The parties are currently waiting for the Court to hand down its judgment. The Court may or may not also rule on the allocation of future costs. B.A.T Industries p.l.c. anticipates that NCR may seek to recover from Appvion (subject to a cap of $25 million for "Future Sites" under the Funding Agreement as described in "— *Funding Agreement of September 30, 2014*") and/or B.A.T Industries p.l.c. 60% of any Kalamazoo clean-up costs for which it is found liable on the basis, it would be asserted, that the river constitutes a "Future Site" for the purposes of the Settlement Agreement. B.A.T Industries p.l.c. believes it may have defenses to any such claim by NCR. The Funding Agreement described above does not resolve any such claims, but does provide an agreed mechanism pursuant to which any surplus from the valuable recoveries of any third-party claims that remains after all Fox River related clean-up costs have been paid and B.A.T Industries p.l.c. and NCR have been made whole may be applied towards Kalamazoo clean-up costs, in the event that NCR were to be successful in any claim for a portion of them from B.A.T Industries p.l.c. or Appvion (subject to Appvion's cap). The quantum of the clean-up costs for the Kalamazoo River is presently unclear (as is the extent of NCR's liability in respect of such costs), but could run into the hundreds of millions of dollars. A witness on behalf of Georgia-Pacific testified in the trial concerning the apportionment of liability that the cost of performing future remediation in Operable Unit 5 of the Kalamazoo River was in the order of $670 million. Operable Unit 5 is the Kalamazoo River itself, as distinct from the other Operable Units which are landfills or other facilities adjoining the Kalamazoo River. Remediation of these other Operable Units has largely been completed except for monitoring.

As detailed above, B.A.T Industries p.l.c. is taking active steps to protect its interests, including seeking to procure the repayment of the Windward dividends, pursuing the other valuable claims that are now within its control, and working with the other parties to the Funding Agreement to maximize recoveries from third parties with a view to ensuring that amounts funded towards clean-up related costs are later recouped under the agreed repayment mechanisms.

Litigation Conclusion

While it is impossible to be certain of the outcome of any particular case or of the amount of any possible adverse verdict, the BAT Group believes that the defenses of the BAT Group's companies to all these various claims are meritorious on both the law and the facts, and a vigorous defense is being made everywhere. An adverse judgment was entered against one BAT Group company, Imperial, in the Quebec class actions and an appeal has been made. If further adverse judgments are entered against any of the BAT Group's companies in any case, all avenues of appeals will be pursued. Such appeals could require the appellants to post appeal bonds or substitute security (as has been necessary in Quebec) in amounts which could in some cases equal or exceed the amount of the judgment.

Certain BAT companies have the benefit of the RJR Tobacco Indemnification with regard to U.S. litigation (excluding the litigation brought by the shareholders of RAI and the Ratcliff personal injury action). Following the completion of the merger, this indemnity would be as between members of the combined group, and as such the combined group would not benefit from an indemnification by an external party.

At least in the aggregate, and despite the quality of defenses available to the BAT Group, it is not impossible that the BAT Group's results of operations or cash flows in particular quarterly or annual periods could be materially affected by this and by the final outcome of any particular litigation.

Having regard to all these matters, with the exception of the Fox River matter, the BAT Group does not consider it appropriate to make any provision in respect of any pending litigation.

Tax Disputes

The BAT Group has exposures in respect of the payment or recovery of a number of taxes. The BAT Group is and has been subject to a number of tax audits covering, among others, excise tax, value added taxes, sales taxes, corporate taxes, withholding taxes and payroll taxes. The estimated costs of known tax obligations have been provided in the BAT Group's accounts in accordance with its accounting policies. In some countries, tax

law requires that full or partial 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 recognized as an expense.

The following matters may proceed to litigation:

Brazil

The Brazilian Federal Tax Authority has filed claims against Souza Cruz seeking to reassess the profits of overseas subsidiaries to corporate income tax and social contribution tax. The reassessments are for the years 2004 until and including 2012 for a total amount of R$1,386 million (£345 million) to cover tax, interest and penalties. The 2011 and 2012 reassessments were raised in December 2016.

Souza Cruz appealed all reassessments. Regarding the first assessments (2004-2006) Souza Cruz appeal was rejected in 2013 although the written judgment of that tribunal was received in 2016. Souza Cruz has appealed the decision. The appeal against the second assessments (2007 and 2008) was upheld at the second tier tribunal and was closed. In 2015, a further reassessment for the same period was raised after the five-year statute of limitation. This has been appealed to the administrative level special chamber.

Souza Cruz received further reassessments in 2014 for the 2009 calendar year and in 2015 an assessment for the 2010 calendar year. Souza Cruz appealed both the reassessments in full. In December 2016, assessments were received for the calendar years 2011 and 2012, which have also been appealed.

South Africa

In 2011 the South African Revenue Service, referred to as SARS, challenged the debt financing of British American Tobacco South Africa, referred to as BATSA, and reassessed the years 2006 to 2008. BATSA has objected to and appealed this reassessment. In 2014, SARS also reassessed the years 2009 and 2010. In 2015, BATSA has filed formal Notices of Appeal and detailed objection letters against the 2009 and 2010 assessments and has reserved its right to challenge the constitutionality of the assessment at a later date. In 2016, SARS has filed a Statement of Grounds of Assessment and BATSA is due to file its Statement of Grounds of Appeal in early 2017. Across the period from 2006 to 2010, the reassessments are for R1.92 billion (£112 million) covering both tax and interest.

Netherlands

In The Netherlands, the Dutch tax authority has issued assessments for the years 2008, 2009, 2011 and 2012 in the sum of €202 million (£172 million) to cover tax, interest and penalties. The assessments relate to a number of intra-group transactions. Objection letters have been filed against the 2008, 2009, 2011 and 2012 assessments. In April 2017, an assessment was issued for the year 2010 for an amount of €14 million (£12 million) to cover tax, interest and penalties. A proforma objection letter has been filed against this assessment.

The BAT Group believes that BAT Group's companies have meritorious defenses in law and fact in each of the above matters in Brazil, South Africa and The Netherlands, and intends to pursue each dispute through the judicial system as necessary. The BAT Group does not consider it appropriate to make provision for these amounts assessed nor for any potential further amounts which may be assessed in subsequent years.

While the amounts that may be payable or receivable in relation to these tax disputes could be material to the results or cash flows of the BAT Group in the period in which they are recognized, the board does not expect these amounts to have a material effect on the BAT Group's financial condition.

VAT and Duty Disputes

Bangladesh

British American Tobacco Bangladesh Company Limited, referred to as BATBC, the operating company, is in receipt of a retrospective notice of imposition and realization of VAT and supplementary duty on low price category brands from the National Board of Revenue (NBR) for approximately £186 million. BATBC is alleged to have evaded tax by selling the products in the low price segments rather than the mid-tier price segments. Management believe that the claims are unfounded. Litigation has proceeded during 2016. The issue is currently awaiting outcome from the Supreme Court, and a 10% deposit may have to be paid during 2017 in order to pursue any appeal.

BUSINESS OF RAI

RAI, the parent company of the RAI Group, is a holding company whose wholly owned operating subsidiaries include the second largest tobacco company in the United States, RJR Tobacco Company; SFNTC, the manufacturer and marketer of the Natural American Spirit brand of cigarettes and other tobacco products in the United States; the second largest smokeless tobacco products manufacturer in the United States, American Snuff Company; R. J. Reynolds Vapor Company, a marketer of digital vapor cigarettes in the United States; Niconovum USA, Inc. and Niconovum AB, marketers of nicotine replacement therapy products in the United States and Sweden, respectively; and until their sale on January 13, 2016, SFRTI and various foreign subsidiaries affiliated with SFRTI, distributors and marketers of the Natural American Spirit brand of cigarettes and other tobacco products outside the United States.

Overview

RAI is the parent company of the RAI Group whose wholly owned operating subsidiaries include RJR Tobacco Company, the second largest tobacco company in the United States, whose brand portfolio includes the premium brands Newport and Camel and the traditional value brand Pall Mall; SFNTC, the manufacturer and marketer of the premium cigarette brand Natural American Spirit; American Snuff Co., the second largest smokeless tobacco products manufacturer in the United States; RJR Vapor, a marketer of digital vapor cigarettes in the United States; Niconovum USA, Inc. and Niconovum AB, marketers of nicotine replacement therapy products in the United States and Sweden respectively.

RAI had consolidated net sales of $6,267 million and consolidated net income of $1,699 million for the six months ended June 30, 2017 (compared to consolidated net sales of $6,112 million and consolidated net income of $4,361 million for the six months ended June 30, 2016). RAI had consolidated net sales of $12,503 million and consolidated net income of $6,073 million for the year ended December 31, 2016 (compared to consolidated net sales of $10,675 million and consolidated net income of $3,253 million for the year ended December 31, 2015).

History and development of the RAI Group

RJR Tobacco Company was founded in 1875 by Richard Joshua Reynolds. In 1913, RJR Tobacco Company introduced Camel cigarettes. In 1954, RJR Tobacco Company introduced Winston, followed by Salem in 1956.

Following RJR Tobacco Company's diversification into foods and other non-tobacco businesses during the 1960s and 1970s, R. J. Reynolds Industries, Inc. was formed as a new parent company of RJR Tobacco Company.

In 1985, R. J. Reynolds Industries, Inc. acquired the Nabisco Brands and was renamed RJR Nabisco, Inc. In 1988, RJR Nabisco, Inc. entered into a merger agreement with Kohlberg Kravis Roberts & Co. ("KKR") for the acquisition of RJR Nabisco by KKR. The merger was completed in 1989 for $25 billion.

In 1999, following the sale of RJR Tobacco Company's international tobacco business to JTI, the remaining tobacco and food businesses were separated. In June 1999, the domestic tobacco business was spun off from RJR Nabisco Holdings Corp, the parent company of RJR Nabisco, as R.J. Reynolds Tobacco Holdings, Inc. which became a separate publicly traded company.

In January 2002, R.J. Reynolds Tobacco Holdings, Inc. acquired SFNTC. Established in 1982, SFNTC is the manufacturer and marketer of Natural American Spirit cigarettes and other tobacco products.

On July 30, 2004, the U.S. assets, liabilities and operations of B&W, a wholly owned subsidiary of BAT, were combined with RJR Tobacco Company. RAI, incorporated on January 2, 2004, became the parent company of the merged U.S. operations of RJR Tobacco Company and B&W. As a result of the B&W business combination and, as described in more detail in below, subsequent share investment in 2015, BAT, through its wholly owned subsidiaries, owned approximately 42% of the outstanding RAI shares.

In May 2006, RAI completed its acquisition of Conwood Company (now the American Snuff Co.), the owner of the Grizzly and Kodiak brands. In December 2009, RAI completed its acquisition of Niconovum AB, a Swedish-based nicotine replacement therapy company and in 2010, Niconovum USA Inc. was formed. In 2012, Niconovum USA, Inc.'s (part of the RAI Group) Zonnic nicotine replacement therapy gum was first marketed in Des Moines, Iowa before expanding nationally in 2014.

R. J. Reynolds Vapor Company was formed in 2012, and started selling its VUSE Digital Vapor Cigarettes in Colorado in June 2013 before expanding nationally in 2014.

Significant recent business combinations, acquisitions and sales

On June 12, 2015, RAI acquired Lorillard in a cash and shares transaction valued at $25.8 billion, pursuant to which (i) a wholly owned subsidiary of RAI merged with and into Lorillard, with Lorillard continuing as the surviving entity and a wholly owned subsidiary of RAI and (ii) Lorillard Tobacco Company LLC, a wholly owned subsidiary of Lorillard, merged with and into RJR Tobacco Company, with RJR Tobacco Company continuing as the surviving entity. Through the acquisition of Lorillard, the Newport cigarette brand was added to RJR Tobacco Company's cigarette brand portfolio.

In addition, on June 12, 2015, ITG Brands, LLC (the "Imperial Sub"), a wholly owned subsidiary of Imperial Brands PLC ("Imperial"), acquired, for $7.1 billion certain assets (i) owned by the RAI Group relating to the cigarette brands Winston, Kool and Salem and (ii) owned by Lorillard subsidiaries or affiliates related to the cigarette brand Maverick and the "e-vapor" brand blu (including Skycig), as well as Lorillard's owned and leased property, and certain transferred employees, together with associated liabilities. As a result of the Lorillard Divestiture, RAI recognized a pre-tax gain of $3.2 billion.

On June 12, 2015, concurrently with the completion of the Lorillard merger and the Lorillard Divestiture, BAT, through a wholly owned subsidiary, purchased 77,680,259 RAI Shares, prior to giving effect to RAI's two-for-one share split, for approximately $4.7 billion, (the "BAT Share Purchase"), as described below, which allowed the BAT Group to collectively maintain its approximate 42% beneficial ownership in RAI.

On January 13, 2016, the RAI Group completed the sale of the international rights to the Natural American Spirit brand name and associated trademarks, along with the international companies that distributed and marketed the brand outside the United States, to JT International Holding BV, a subsidiary of JTI, in an all-cash transaction of approximately $5 billion, and recognized a pre-tax gain of approximately $4.9 billion. The transaction did not include the rights to the Natural American Spirit brand name and associated trademarks in the U.S. market, U.S. duty-free locations and U.S. territories or in U.S. military outlets worldwide, all of which have been retained by SFNTC. Following this transaction, the international rights to nearly all of the RAI Group's cigarette trademarks are owned by international tobacco companies.

On July 25, 2017, RAI became an indirect, wholly owned subsidiary of BAT. For more information on the transaction, see "*The Merger*".

Share split

On July 27, 2015, RAI's board of directors approved a two-for-one share split of RAI Shares, in the form of a 100% dividend, which was issued on August 31, 2015. RAI Shareholders received one additional RAI Share for each RAI Share owned.

Brands and products

Operational segments of RAI

RAI's reportable operating segments are: (i) RJR Tobacco; (ii) Santa Fe; and (iii) American Snuff. The RJR Tobacco segment consists of the primary operations of RJR Tobacco Company. The Santa Fe segment consists of the primary operations of SFNTC. The American Snuff segment consists of the primary operations of American Snuff Co. Included in All Other, among other RAI subsidiaries, are RJR Vapor, Niconovum USA, Inc. and Niconovum AB.

RJR Tobacco

Overview

RAI's largest operating segment, RJR Tobacco, is the second largest tobacco company in the United States. RJR Tobacco's brands include three of the top four best-selling cigarettes in the United States: Newport, Camel and Pall Mall, also referred to as the "drive brands". These "drive brands", and its other brands, including Doral, Misty and Capri, are manufactured in a variety of styles and marketed in the United States. As part of its total tobacco strategy, RJR Tobacco offers a smokeless tobacco product, Camel Snus, a heat-treated tobacco product sold in individual pouches that provide convenient tobacco consumption.

For the six months ended June 30, 2017, the domestic sales volumes for the RJR Tobacco segment were 37.6 billion cigarettes (compared to 39.3 billion cigarettes for the six-month period ended June 30, 2016). Net sales for the RJR Tobacco segment were $5,046 million for the six months ended June 30, 2017 (compared to $5,057 million for the six-month period ended June 30, 2016). For the year ended December 31, 2016, the domestic sales volumes for the RJR Tobacco segment were 79.4 billion cigarettes (compared to 71.3 billion

cigarettes and 61 billion cigarettes for the years ended December 31, 2015 and December 31, 2014, respectively). Net sales for the RJR Tobacco segment were $10,314 million for the year ended December 31, 2016 (compared to $8,634 million and $6,767 million for the years ended December 31, 2015 and December 31, 2014, respectively).

RJR Tobacco manages contract manufacturing of cigarettes and tobacco products through arrangements with the BAT Group, and manages the export of tobacco products to U.S. territories, U.S. duty-free shops and U.S. overseas military bases. In the United States, RJR Tobacco also manages the premium cigarette brands Dunhill, which RJR Tobacco Company licenses from the BAT Group, and State Express 555, which RJR Tobacco Company licenses from CTBAT, a joint venture between the BAT Group and CNTC.

RJR Tobacco primarily conducts business in the highly competitive U.S. cigarette market. The international rights to substantially all of RJR Tobacco's brands were sold in 1999 to JTI, and no international rights were acquired in connection with the B&W business combination or the Lorillard merger. The U.S. cigarette market, which has a few large manufacturers and many smaller participants, is a mature market in which overall adult consumer demand has declined since 1981, and is expected to continue to decline. MSAi reported that U.S. cigarette shipments declined 2.4% in 2016 to 258 billion cigarettes, 0.1% in 2015 (264.3 billion cigarettes) and 3.2% in 2014 (264.6 billion cigarettes). From year to year, shipments are impacted by various factors including price increases, excise tax increases and wholesale inventory adjustments.

Competition

RJR Tobacco's primary competitors are Philip Morris USA and Imperial Sub, as well as manufacturers of deep-discount brands. Deep-discount brands are brands manufactured by companies that are not original or subsequent participating manufacturers to the State Settlement Agreements. Accordingly, these non-participating manufacturers to the State Settlement Agreements do not have cost structures burdened with payments related to State Settlement Agreements to the same extent as the original or subsequent participating manufacturers. For further information, see "*Management's Discussion and Analysis of Financial Condition And Results of Operations of RAI — Litigation and Settlements*".

Based on STR Data, during each of 2016 and 2015, RJR Tobacco had an overall retail share of the U.S. cigarette market of 32.3% and in 2014, a market share of 32.1%, reflecting the pro forma impact of the Lorillard merger and the Lorillard Divestiture. During each of these same years, Philip Morris USA had an overall retail share of the U.S. cigarette market of 49.9% in 2016 and 2015 and 49.3% in 2014, respectively.

Competition is based primarily on brand positioning, including price, product attributes and packaging, consumer loyalty, promotions, advertising and retail presence, as well as finding efficient and effective means of balancing market share and profit growth. Cigarette brands produced by the major manufacturers generally require competitive pricing, substantial marketing support, retail programs and other incentives to maintain or improve market position or to introduce a new brand or brand style. Competition among the major cigarette manufacturers continues to be highly competitive and includes product innovation and expansion into smokeless tobacco categories.

Marketing

RJR Tobacco's marketing programs are designed to strengthen brand image, build brand awareness and loyalty, and switch adult smokers of competing brands to RJR Tobacco brands. In addition to building strong brand awareness, RJR Tobacco's marketing approach uses a retail pricing strategy, including discounting at retail, to defend certain brands' shares of market against competitive pricing pressure. RJR Tobacco's competitive pricing methods may include list price changes, discounting programs, such as retail and wholesale buy downs, periodic price reductions, off-invoice price reductions, U.S. dollar-off promotions and consumer coupons. Retail buy downs refer to payments made to the retailer to reduce the price that consumers pay at retail. Consumer coupons are distributed by a variety of methods.

RJR Tobacco provides trade incentives through trade terms, wholesale partner programs and retail incentives. Trade discounts are provided to wholesalers based on compliance with certain terms. The wholesale partner programs provide incentives to RJR Tobacco's direct buying customers based on performance levels. Retail incentives are paid to the retailer based on compliance with RJR Tobacco Company's contract terms.

RJR Tobacco's cigarette brand portfolio strategy is based upon two brand categories: drive and other. The drive brands consist of two premium brands, Newport and Camel, and the largest traditional-value brand in the United States, Pall Mall. These three drive brands are managed for long-term market share and profit growth and receive the vast majority of RJR Tobacco's equity support, with an emphasis on the Newport and Camel brands. The other brand category includes the premium brand, Capri, and the value brands, Doral and Misty, along with other smaller brands. All of the other brands receive limited marketing support and are managed to maximize profitability.

The key objectives of the portfolio strategy are designed to balance the long-term market share growth and profitability of the drive brands while managing the other brands for long-term sustainability and profitability. Consistent with that strategy, RJR Tobacco continues to evaluate some of its non-core cigarette styles for potential elimination.

Anti-tobacco groups continue to attempt to restrict cigarette sales, cigarette advertising, and the testing and introduction of new tobacco products as well as encourage smoking bans. The MSA and U.S. federal, state and local laws and regulations, including the FDA Tobacco Act and related regulations, restrict or prohibit the use of television, radio or billboard advertising or certain other marketing and promotional tools for cigarettes and smokeless tobacco products. RJR Tobacco continues to use direct mailings, websites and other means to market its brands and enhance their appeal among age-verified adults who use tobacco products. RJR Tobacco continues to advertise and promote at retail locations and in adult venues and also uses print advertising in newspapers and consumer magazines in the United States, where permitted.

Manufacturing and distribution

RJR Tobacco Company owns its manufacturing facilities, located in the Winston-Salem, North Carolina area. RJR Tobacco has a total production capacity of approximately 115 billion cigarettes per year. RJR Tobacco distributes its cigarettes primarily through a combination of direct wholesale deliveries from two local distribution centers and public warehouses located throughout the United States.

RJR Tobacco Company has entered into various transactions with the BAT Group. RJR Tobacco sells contract-manufactured cigarettes, tobacco leaf and processed tobacco to the BAT Group. In January 2016, RJR Tobacco Company received written notice from a BAT subsidiary terminating a cigarette contract manufacturing agreement, effective January 5, 2019. In July 2016, such contract manufacturing agreement was amended to permit an early transition of the cigarette production, covered by the agreement, to the BAT Group's facilities, which began in the fourth quarter of 2016. Net sales, primarily of cigarettes, to the BAT Group represented approximately 2% of RAI's total net sales in each of 2016 and 2015, and 4% in 2014.

Raw materials

In its production of tobacco products, RJR Tobacco uses U.S. and foreign grown (primarily in Brazil) flue-cured and burley leaf tobaccos, as well as Oriental leaf tobaccos grown primarily in Turkey, Macedonia and Bulgaria. RJR Tobacco Company believes that there is a sufficient supply of tobacco leaf in the worldwide tobacco market to satisfy its current and anticipated production requirements.

RJR Tobacco purchases the majority of its U.S. flue-cured and burley tobacco leaf directly through contracts with tobacco growers. These short-term contracts are frequently renegotiated. RJR Tobacco believes that the relationship with its tobacco leaf suppliers is good.

RJR Tobacco also uses other raw materials such as filter tow, filter rods and fire standards compliant paper, which are sourced from either one supplier or a few suppliers. RJR Tobacco believes that it has reasonable measures in place designed to mitigate the risk posed by the limited number of suppliers of certain raw materials.

Santa Fe

Overview

Santa Fe manufactures and markets premium cigarettes and other tobacco products under the Natural American Spirit brand in the United States.

For the six months ended June 30, 2017, the domestic sales volumes for the Santa Fe segment were 2.7 billion cigarettes (compared to 2.6 billion cigarettes for the six-month period ended June 30, 2016). Net sales for the Santa Fe segment were $516 million for the six months ended June 30, 2017 (compared to $465 million for the six-month period ended June 30, 2016). For the year ended December 31, 2016, the domestic sales volumes for the Santa Fe segment were 5.4 billion cigarettes (compared to 4.8 billion cigarettes and 3.9 billion cigarettes for the years ended December 31, 2015 and 2014, respectively). Net sales for the Santa Fe segment were $973 million for the year ended December 31, 2016 (compared to $818 million and $658 million for the years ended December 31, 2015 and 2014, respectively).

Competition

Santa Fe manufactures and markets premium cigarettes and other tobacco products under the Natural American Spirit brand in the United States. The Natural American Spirit brand is a top ten best-selling cigarette brand in the United States. Based upon STR Data, during 2016, 2015 and 2014, Santa Fe had an overall retail share of the U.S. cigarette market of 2.2%, 1.9% and 1.5%, respectively.

Marketing

SFNTC is a subsequent participating manufacturer in the MSA. The MSA and U.S. federal, state and local laws and regulations, including the FDA Tobacco Act and related regulations, restrict or prohibit use of television, radio or billboard advertising or certain other marketing and promotional tools for cigarettes and other tobacco products. Santa Fe continues to use direct mailings, websites and other means to market its brand and enhance its appeal among age-verified adults who use tobacco products. Santa Fe continues to advertise and promote at retail locations and in adult venues, and uses print advertising in consumer magazines and other publications in the United States, where permitted.

Manufacturing and distribution

SFNTC owns its manufacturing facility, which is located in Oxford, North Carolina. Santa Fe distributes its products primarily through a combination of direct wholesale deliveries from a distribution center in North Carolina and public warehouses located throughout the United States.

Raw materials

Santa Fe's support for sustainable agriculture and natural resources is part of its commitment to the environment. Santa Fe contracts directly with independent farmers and advocates earth-friendly practices through its two growing programs, Purity Residue Clean, which uses environmentally friendly cultivation practices, and Certified Organic, which follows the guidelines of the United States Department of Agriculture's National Organic Program. In the production of its tobacco products, Santa Fe purchases electricity generated from renewable sources, including wind power, and operates a zero waste-to-landfill manufacturing facility.

American Snuff

Overview

American Snuff, is the second largest smokeless tobacco products manufacturer in the United States, and offers adult tobacco consumers a range of differentiated smokeless tobacco products, primarily moist snuff. The moist snuff category is divided into premium, price-value and popular-price brands. American Snuff's primary brands include its largest selling moist snuff brands, Grizzly, in the price-value category, and Kodiak, in the premium category.

In contrast to the declining U.S. cigarette market, U.S. moist snuff retail volumes grew approximately 2.0%, 3.6%, 2.0% and 2.3% in the twelve months ended June 30, 2017 and the years ended December 31, 2016, 2015 and 2014, respectively. Moist snuff's growth is partially attributable to cigarette smokers switching from cigarettes to smokeless tobacco products or using both.

Moist snuff has been the key driver to American Snuff's overall growth and profitability within the U.S. smokeless tobacco market and accounted for approximately 93%, 91%, 90% and 89% of its revenue in the six months ended June 30, 2017 and the years ended December 31, 2016, 2015 and 2014, respectively. Profit margins on moist snuff products are generally higher than on cigarette products.

For the six months ended June 30, 2017, the sales volume for the American Snuff segment was 260.1 million cans (compared to 249.1 million cans for the six-month period ended June 30, 2016). Net sales for the American Snuff segment were $503 million for the six months ended June 30, 2017 (compared to $448 million for the six-month period ended June 30, 2016). For the year ended December 31, 2016, the sales volume for the American Snuff segment was 502.9 million cans (compared to 499.1 million cans and 478.6 million cans for the years ended December 31, 2015 and 2014, respectively). Net sales for the American Snuff segment were $914 million for the year ended December 31, 2016 (compared to $855 million and $783 million for the years ended December 31, 2015 and 2014, respectively).

Competition

American Snuff is dependent on the U.S. smokeless tobacco products market and competes in that market with other domestic and international companies. The highly competitive moist snuff category has developed many of the characteristics of the larger cigarette market, including multiple pricing tiers, focused marketing programs and significant product innovation. Similar to the cigarette market, competition is based primarily on brand positioning and price, as well as product attributes and packaging, consumer loyalty, promotions, advertising and retail presence.

American Snuff's retail share of the U.S. moist snuff market, according to STR Data, was 33.4%, 33.7% and 32.9% in 2016, 2015 and 2014, respectively. Grizzly moist snuff had a market share of 30.8%, 30.9% and 30.0% in 2016, 2015 and 2014, respectively. American Snuff's largest competitor is U.S. Smokeless Tobacco Company LLC which had approximately 54.7%, 54.0% and 54.4% of the U.S. moist snuff market share in 2016, 2015 and 2014, respectively.

Marketing

American Snuff's marketing programs are designed to enhance brand image, build brand awareness and loyalty, and switch adult smokeless tobacco consumers of competing brands to American Snuff's brands. U.S. federal, state and local laws and regulations, including the FDA Tobacco Act and related regulations, restrict or prohibit use of television, radio or billboard advertising or certain other marketing and promotional tools for smokeless tobacco products.

American Snuff's brand portfolio strategy consists of the drive brand, Grizzly, a leading moist snuff brand in the United States, and non-support brands that consist of all other brands. American Snuff is focusing on growing market share and profitability of its Grizzly branded products through brand equity building initiatives and promotions. American Snuff also offers Grizzly pouches, which provide pre-measured portions that are more convenient than traditional, loose moist snuff. Pouches represented approximately 20% of the total U.S. moist snuff market as at December 31, 2016. During 2016, demand for pouches continued to grow at more than triple the overall category rate.

Manufacturing and distribution

American Snuff Co. owns its manufacturing facilities located in Memphis, Tennessee; Clarksville, Tennessee; and Winston-Salem, North Carolina. American Snuff distributes its products primarily through a combination of direct wholesale deliveries from a distribution center in North Carolina and public warehouses located throughout the United States.

Raw Materials

In its production of moist snuff, American Snuff uses U.S. fire-cured and air-cured leaf tobaccos as well as foreign, primarily Brazilian, burley and air-cured leaf tobaccos. American Snuff purchases the majority of its U.S. fire-cured and air-cured tobacco leaf directly through contracts with tobacco growers. These short-term contracts are frequently renegotiated. American Snuff Co. believes the relationship with its tobacco leaf suppliers is good, and there is a sufficient supply of leaf in the worldwide tobacco leaf market to satisfy its current and anticipated production requirements.

All Other

RJR Vapor markets VUSE Digital Vapor Cigarette products, which include VUSE Solo, VUSE Fob and VUSE Vibe. VUSE is the top-selling vapor product in convenience/gas stores and is available in more than 110,000 retail outlets across the United States. Its innovative digital technology is designed to deliver a consistent flavor and vapor experience.

In March 2016, RJR Vapor introduced its VUSE Fob power unit, which integrates Bluetooth® technology and offers an on-device display with information about battery and cartridge levels. RJR Vapor began national distribution in November 2016 of its VUSE Vibe high-volume cartridge and closed-tank system with a stronger and longer-lasting battery.

All production of VUSE Solo cartridges is performed at RJR Tobacco Company's manufacturing facility, pursuant to a services agreement between RJR Tobacco Company and RJR Vapor.

Niconovum USA, Inc. is a marketer of a nicotine replacement therapy gum, Zonnic, which is available in approximately 40,000 retail outlets across the United States. Niconovum AB is a marketer of nicotine replacement therapy products in Sweden under the Zonnic brand name.

On January 13, 2016, RAI, through certain subsidiaries, completed the sale of the international rights to the Natural American Spirit brand name and associated trademarks, along with SFRTI and other international companies that distributed and marketed the brand outside the United States, to JTI, in an all-cash transaction with a value of approximately $5 billion. Prior to such sale, such operations were included in All Other.

For the year ended December 31, 2016, net sales for All Other were $302 million (compared to $368 million and $263 million for the years ended December 31, 2015 and 2014, respectively).

Customers

The largest customer of RJR Tobacco, Santa Fe and American Snuff is the distributor McLane. Sales to McLane constituted approximately 28% of the RAI Group's consolidated revenue for each of the years ended December 31, 2016 and 2015 and 31% for the year ended December 31, 2014. RJR Tobacco, Santa Fe and American Snuff sales to the distributor Core-Mark represented approximately 14%, 10% and 11% of the RAI Group's consolidated revenue for the years ended December 31, 2016, 2015 and 2014, respectively. No other customer accounted for 10% or more of the RAI Group's consolidated revenue during those periods. Sales of RJR Tobacco, Santa Fe and American Snuff to McLane and Core-Mark are not governed by any written supply contract. RJR Tobacco, Santa Fe and American Snuff believe that their relationships with McLane and Core-Mark are good. No significant backlog of orders existed at RJR Tobacco, Santa Fe or American Snuff as at December 31, 2016, 2015 or 2014.

Sales to foreign countries

The RAI Group's sales to foreign countries, including sales to the BAT Group were $351 million, $482 million and $497 million for the years ended December 31, 2016, 2015 and 2014, respectively.

Research and development

The research and development activities of the RAI Group are primarily conducted at RJR Tobacco Company's facility in Winston-Salem, North Carolina through various intercompany service agreements. Scientists and engineers continue to explore the development of innovative products, packaging and processes, as well as harm reduction technologies, modified risk tobacco products and analytical methodologies. Another key activity for research and development is to assist the RAI Group in complying with regulations of the FDA, and to adhere to future FDA regulations and approval processes.

The RAI Group's research and development expense was $101 million, $107 million and $88 million for the years ended December 31, 2016, 2015 and 2014, respectively.

Intellectual property

The RAI Group owns or has the right to use numerous trademarks, including the brand names of their products and the distinctive elements of their packaging and displays, and numerous patents. The RAI Group's material patents and trademarks are registered with the U.S. Patent and Trademark Office, and certain corresponding patents and trademarks are registered in other countries throughout the world. Rights in the U.S. patents will expire in accordance with their individual statutory terms, and rights in the trademarks in the United States will last as long as the RAI Group continues to use the trademarks. The RAI Group considers the distinctive blends and recipes used to make each of its brands to be trade secrets. These trade secrets are not patented, but the RAI Group takes appropriate measures to protect the unauthorized disclosure of such information.

In 1999, RJR Tobacco Company sold most of its trademarks and patents outside the United States in connection with the sale of the international tobacco business to JTI. The sale agreement granted JTI the right to use certain of RJR Tobacco Company's trade secrets outside the United States, but details of the ingredients or formulas for flavors and the blends of tobacco may not be provided to any sub-licensees or sub-contractors. The agreement also generally prohibits JTI and its licensees and sub-licensees from the sale or distribution of tobacco products of any description employing the purchased trademarks and other intellectual property rights in the United States. In 2005, the U.S. duty-free and U.S. overseas military businesses relating to certain brands were re-acquired from JTI.

In addition to the intellectual property rights it directly owns, RJR Tobacco Company has certain rights with respect to BAT intellectual property that were available for use by B&W prior to the completion of the B&W business combination.

Pursuant to the sale by certain members of the RAI Group of the international rights to the Natural American Spirit brand name and associated trademarks to JTI in January 2016, RAI and its controlled affiliates have agreed not to engage in the business of producing, selling, distributing and developing natural, organic and additive-free combustible tobacco cigarettes and roll-your-own or make-your-own tobacco products outside the United States, and JTI and its controlled affiliates have agreed not to engage in the conduct of such business in the United States, in each case, for five years following the closing of the transaction.

Employees

As of December 31, 2016, the RAI Group had approximately 5,500 full-time employees and approximately 50 part-time employees. No employees of the RAI Group are unionized. The following table sets forth the approximate number of RAI Group employees by operating subsidiary as of December 31, 2016, 2015 and 2014:

RAI Subsidiary

	As of December 31,		
	2016	2015	2014
	(number of employees worldwide)		
RJR Tobacco Company	3,700	3,800	3,600
SFNTC	500	500	600
American Snuff Co	600	600	400
Total Full-Time Employees	**5,500**	**5,600**	**5,300**

Governmental Activity

The marketing, sale, taxation and use of tobacco products have been subject to substantial regulation by government and health officials for many years. Various state and/or local governments have adopted or are considering, among other things, legislation and regulations that would:

- significantly increase their taxes on all tobacco products;
- restrict displays, advertising and sampling of tobacco products;
- raise the minimum age to possess or purchase tobacco products;
- restrict or ban the use of menthol in cigarettes or prohibit the use of characterizing flavors in smokeless tobacco products and vapor products;
- require the disclosure of ingredients used in the manufacture of tobacco products;
- require the disclosure of nicotine yield information for cigarettes;
- impose restrictions on smoking and vaping in public and private areas; and
- restrict the sale of tobacco products directly to consumers or other unlicensed recipients, including by mail or over the Internet.

Together with substantial increases in state and federal taxes on tobacco products, and the granting to the FDA of broad authority over the manufacture, sale, marketing and packaging of tobacco products, these developments have had and will likely continue to have an adverse effect on the sale of tobacco products. Products that are alternatives to traditional tobacco products also have become subject to increasing regulation. For example, in addition to the regulation by the FDA of e-cigarettes, as described below, various states have adopted, or are considering adoption of taxes on e-cigarettes, restrictions on the promotion and distribution of e-cigarettes, and tamper resistant and child resistant packaging requirements for e-cigarettes.

Taxation

General

Cigarettes and other tobacco products are subject to substantial taxes in the United States. As a result of a 2009 federal law which increased taxes on cigarettes and other tobacco products:

- the federal excise tax per pack of 20 cigarettes is $1.01; and
- the federal excise tax rate for chewing tobacco is $0.5033 per pound, and for snuff is $1.51 per pound.

Currently, there is no federal tax on vapor products, such as e-cigarettes.

On February 9, 2016, President Obama released a budget in which he proposed increasing the federal excise tax: on a pack of cigarettes from $1.01 to $1.95; for snuff from $1.51 per pound to $2.93 per pound; and for chewing tobacco from $0.5033 per pound to $0.98 per pound. These proposed tax increases would fund a new initiative for pre-kindergarten education for lower-income children. RAI's management believes that such tax increases would have an adverse impact on the sale of tobacco products by RAI's operating companies and could have a material adverse effect on the results of operations, cash flows or financial position of RAI, including impairment of the value of its operating subsidiaries' trademarks.

Cigarettes

The 2009 federal excise tax increase on tobacco products increased taxes on ready-made cigarettes, such as those made by RJR Tobacco Company and SFNTC, at a much higher rate than taxes on loose tobacco. As a result of that tax disparity, the number of retailers selling loose tobacco and operating roll-your-own machines, allowing consumers to convert the loose tobacco into finished cigarettes, greatly increased following the 2009 federal tax hike on tobacco products. On July 6, 2012, President Obama signed into law a provision classifying retailers which operate roll-your-own machines as cigarette manufacturers, and thus requiring those retailers to pay the same tax rate as other cigarette manufacturers. As of June 30, 2017, 26 states also had passed legislation classifying retailers operating roll-your-own machines as cigarette manufacturers.

All states and the District of Columbia currently impose cigarette excise taxes at levels ranging from $0.17 per pack in Missouri to $4.35 per pack in New York. As of June 30, 2017 and December 31, 2016, the weighted average state cigarette excise tax per pack, calculated on a 12-month rolling average basis, was approximately $1.53 and $1.39, respectively. Certain city and county governments, such as New York, Philadelphia and Chicago, also impose substantial excise taxes on cigarettes sold in those jurisdictions. During the first six months of 2017, 23 states proposed legislation to increase their cigarette excise taxes, with such legislation being adopted, effective August 24, 2017, in one state (Oklahoma), failing in 15 states and remaining pending, as of June 30, 2017, in seven states. RJR Tobacco Company, together with wholesalers, retailers and another cigarette manufacturer, have brought a lawsuit challenging, on state constitutional grounds, the basis upon which the Oklahoma tax increase was passed. The case is pending. During 2016, 23 states proposed increases in their respective cigarette excise taxes, with increases being adopted in four states (Louisiana, Pennsylvania, West Virginia and California) and failing in 19 states. In connection with the November 2016 general election, California approved a ballot proposal increasing, effective April 1, 2017, that state's cigarette excise tax per pack from $0.87 to $2.87. Ballot proposals in Colorado, Missouri and North Dakota to increase those states' respective cigarette excise taxes failed in the November 2016 general election. If the foregoing California cigarette excise tax increase had been in effect as of December 31, 2016, the weighted average state cigarette excise tax per pack, calculated on a 12-month rolling average basis, would have been $1.526, instead of $1.39.

Six states now require NPMs to pay a fee on each pack of cigarettes sold in their respective states, ranging from $0.25 per pack in Alaska to $0.55 per pack in Texas.

The Texas equity fee has been challenged by a coalition of small tobacco manufacturers. This group asserts that the Texas fee violates the Texas Constitution's "Equal and Uniform" Clause, as well as the Equal Protection and Due Process Clauses of the U.S. Constitution. On November 15, 2013, a state trial court in Texas declared the equity fee unconstitutional and enjoined the state from "assessing, collecting, and enforcing" the fee. The State of Texas appealed the court's order. In doing so, enforcement of the trial court's order, including the injunction, is suspended. On August 15, 2014, the three-judge panel unanimously affirmed the ruling, and on October 29, 2014, the State of Texas filed its petition for review with the Texas Supreme Court. On April 1, 2016, the Texas Supreme Court reversed the Texas Court of Appeals, and ruled that the Texas equity fee legislation does not violate the Equal and Uniform Clause of the Texas constitution. The Texas Supreme Court remanded the case back to the Texas Court of Appeals for that court to consider the non-settling manufacturers' remaining challenges to the equity fee. On June 20, 2016, plaintiffs filed a motion for rehearing with the Texas Supreme Court. That motion was denied. After the case was remanded back to the Texas Court of Appeals, both the plaintiffs and the State of Texas filed supplemental briefs with the court. Further proceedings before the Texas Court of Appeals are anticipated.

Smokeless

As of June 30, 2017, all states and the District of Columbia subjected smokeless tobacco products to excise taxes, as summarized below:

- 27 states taxed moist snuff on an ad valorem basis, at rates ranging from 5% in South Carolina to 210% in Massachusetts;
- 23 states and the District of Columbia had weight-based taxes on moist snuff, ranging from $0.02 for cans weighing between ⅝ of an ounce and 1⅝ ounces in Alabama to $2.02 per ounce in Maine; and
- two states imposed a unit tax on moist snuff: Kentucky with a tax of $0.19 per unit, and Washington, with a tax of $2.526 per unit for units weighing 1.2 ounces or less and a proportionate amount above that weight. In addition, Minnesota imposed a tax on moist snuff at a rate equal to the greater of (1) 95% of the wholesale price and (2) generally, the tax equal to the rate imposed on a pack of 20 cigarettes.

During the first six months of 2017, 15 states proposed increases in their excise taxes on smokeless tobacco products, with such legislation failing in eight states and remaining pending, as of June 30, 2017, in seven states.

Vapor Products

As of June 30, 2017, six states and the District of Columbia imposed a tax on vapor products, such as e-cigarettes, as follows: Minnesota, which taxes vapor products at the same rate as it taxes smokeless tobacco products (95% of the wholesale price); Louisiana, North Carolina, Kansas and West Virginia, which tax vapor products at a per fluid milliliter rate of $0.05, $0.05, $0.20 and $0.075, respectively; and the District of Columbia and Pennsylvania, which tax vapor products at an ad valorem rate of 65% and 40%, respectively. As part of the ballot initiative that was approved in California in November 2016, vapor products were taxed in that state at an ad valorem rate of 27.3% from April 1, 2017 to June 30, 2017. Effective July 1, 2017, California's ad valorem rate on vapor products increased to 65.08%. California's ad valorem rate on vapor products is subject to potential further adjustment on July 1 of each year. Further, during the first six months of 2017, 24 states proposed taxes on vapor products, including, in some cases, implementing a tax on a per fluid milliliter basis, taxing vapor products on the same basis as "other tobacco products" and, in other cases, taxing vapor products at a rate equivalent to cigarette excise taxes. Such legislation was adopted in one state, failed in 15 states, and, as of June 30, 2017, remained pending in eight states.

Federal Regulation — General

In 1964, the Report of the Advisory Committee to the Surgeon General of the U.S. Public Health Service concluded that cigarette smoking was a health hazard of sufficient importance to warrant appropriate remedial action. Since 1966, federal law has required a warning statement on cigarette packaging, and cigarette advertising in other media also is required to contain a warning statement. Since 1971, television and radio advertising of cigarettes has been prohibited in the United States.

The warnings currently required on cigarette packages and advertisements are:

- "SURGEON GENERAL'S WARNING: Smoking Causes Lung Cancer, Heart Disease, Emphysema, And May Complicate Pregnancy;"
- "SURGEON GENERAL'S WARNING: Quitting Smoking Now Greatly Reduces Serious Risks to Your Health;"
- "SURGEON GENERAL'S WARNING: Smoking By Pregnant Women May Result in Fetal Injury, Premature Birth, And Low Birth Weight;" and
- "SURGEON GENERAL'S WARNING: Cigarette Smoke Contains Carbon Monoxide." As noted below, the FDA has proposed regulations that would revise the foregoing warnings.

Since the initial report in 1964, the Secretary of Health, Education and Welfare, now the Secretary of Health and Human Services, and the U.S. Surgeon General have issued a number of other reports which purport to find the nicotine in cigarettes addictive and to link cigarette smoking and exposure to cigarette smoke with certain health hazards, including various types of cancer, coronary heart disease and chronic obstructive lung disease. These reports have recommended various governmental measures to reduce the incidence of smoking. In 1992, the federal Alcohol, Drug Abuse and Mental Health Act was signed into law. This act required states to adopt a minimum age of 18 for purchase of tobacco products and to establish a system to monitor, report and reduce the illegal sale of tobacco products to minors in order to continue receiving federal funding for mental health and drug abuse programs. In 1996, the U.S. Department of Health and Human Services announced regulations implementing this legislation. And in 2006, the U.S. Surgeon General released a report entitled "The Health Consequences of Involuntary Exposure to Tobacco Smoke." Among its conclusions, the report found the following: exposure of adults to secondhand smoke causes coronary heart disease and lung cancer, exposure of children to secondhand smoke results in an increased risk of sudden infant death syndrome, acute respiratory infections, ear problems and more severe asthma; and that there is no risk-free level of exposure to secondhand smoke. A follow-up report issued by the U.S. Surgeon General in 2010, "How Tobacco Smoke Causes Disease: The Biology and Behavioral Basis for Smoking-Attributable Disease," determined that tobacco smoke causes immediate cellular damage and tissue inflammation and that repeated exposure impedes the healing of such damage and inflammation. On January 17, 2014, the U.S. Surgeon General issued an additional report that contends that smoking is linked to a higher number of deaths to Americans than previous estimates, and that cigarettes are a causal factor in ten conditions and diseases that had not previously been directly linked to cigarette smoking.

In December 2016, the U. S. Surgeon General issued a report on e-cigarettes, raising public health concerns regarding the use of e-cigarettes by U.S. youth and young adults. The report recommended that state, local, tribal, and territorial governments implement additional laws and regulations to address e-cigarette use among youth and young adults, including:

- incorporating e-cigarettes into existing smoke-free policies;
- preventing youth access to e-cigarettes through various restrictions on sales of e-cigarettes to minors (including age verification requirements, prohibitions against self-service displays, and active enforcement of existing laws);
- implementing taxation and other price policies for e-cigarettes;
- increasing regulation of e-cigarette marketing by expanding evidence and facilitating the development of constitutionally feasible restrictions on such marketing; and
- targeting youth and young adults with educational initiatives on e-cigarettes and their potential for nicotine addiction and adverse health consequences.

The report also calls for expanded federal funding of e-cigarette research efforts, including research on health risks and the impact of governmental policies on initiation and use patterns for e-cigarettes and other tobacco products. Finally, the report recommends continued surveillance of e-cigarette marketing to assess the link between exposure to e-cigarette marketing and use of these products.

In 1986, Congress enacted the Comprehensive Smokeless Tobacco Health Education Act of 1986, which, among other things, required health warning notices on smokeless tobacco packages and advertising and prohibited the advertising of smokeless tobacco products on any medium of electronic communications subject to the jurisdiction of the Federal Communications Commission. In 2009, the FDA Tobacco Act (discussed below) amended the Comprehensive Smokeless Tobacco Health Education Act of 1986 to require the following warnings on smokeless tobacco packaging and advertising, displayed randomly and as equally as possible in each 12-month period:

- "WARNING: THIS PRODUCT CAN CAUSE MOUTH CANCER;"
- "WARNING: THIS PRODUCT CAN CAUSE GUM DISEASE AND TOOTH LOSS;"
- "WARNING: THIS PRODUCT IS NOT A SAFE ALTERNATIVE TO CIGARETTES;" and
- "WARNING: SMOKELESS TOBACCO IS ADDICTIVE."

FDA Tobacco Act

General

In 2009, President Obama signed into law the FDA Tobacco Act, which grants the FDA broad authority over the manufacture, sale, marketing and packaging of tobacco products. Pursuant to the FDA Tobacco Act:

- charitable distributions of tobacco products are prohibited;
- statements that would lead consumers to believe that a tobacco product is approved, endorsed, or deemed safe by the FDA are prohibited;
- pre-market approval by the FDA is required for claims made with respect to reduced risk or reduced exposure products;
- the marketing of tobacco products in conjunction with any other class of product regulated by the FDA is prohibited;
- tobacco manufacturers are banned from selling cigarettes with characterizing flavors (other than menthol, which under the FDA Tobacco Act is specifically exempt as a characterizing flavor, but the impact of which on public health will be studied as discussed below);
- all manufacturers are required to register with the FDA their domestic manufacturing facilities as well as all cigarette and smokeless tobacco products sold in the United States;
- the FDA reissued regulations addressing advertising and marketing restrictions that were originally promulgated in 1996 (including, among other restrictions, prohibitions on: the sale of cigarettes and

smokeless tobacco products to persons under the age of 18; the sale of packages of cigarettes with less than 20 cigarettes; the distribution of free samples of cigarettes; and brand name sponsorship of any athletic, musical or other social/cultural events);

- manufacturers were required to produce health-related documents generated from and after June 22, 2009 through December 31, 2009 (the FDA has interpreted the FDA Tobacco Act as establishing an ongoing requirement to submit health-related documents; however, the FDA has not yet established a timetable for further production);
- manufacturers are required to make by-brand ingredient submissions, place different and larger warnings on packaging and advertising for smokeless tobacco products and eliminate the use of descriptors on tobacco products, such as "low-tar" and "lights";
- the FDA issued a final regulation for the imposition of larger, graphic health warnings on cigarette packaging and advertising, which was scheduled to take effect September 22, 2012, but the FDA is currently enjoined from enforcing such regulation;
- as described in greater detail below, new or modified products introduced in the market after February 15, 2007 are subject to certain FDA clearance requirements;
- the FDA announced that it would inspect every domestic establishment that manufactured cigarettes, cigarette tobacco, roll-your-own tobacco or smokeless tobacco products once in a two-year cycle beginning October 1, 2011;
- in April 2012, the FDA issued draft guidance on: (1) the reporting of harmful and potentially harmful constituents in tobacco products and tobacco smoke pursuant to Section 904(a)(3) of the FDA Tobacco Act, and (2) preparing and submitting applications for modified risk tobacco products pursuant to Section 911 of the FDA Tobacco Act; and
- in December 2016, the FDA issued a revised final guidance document entitled, "Demonstrating the Substantial Equivalence of a New Tobacco Product: Response to Frequently Asked Questions (Edition 3)." The revised guidance was the result of a decision by the United States District Court for the District of Columbia finding that the FDA's prior guidance that labeling changes trigger the requirement for premarket review contradicts the language of the FDA Tobacco Act and exceeds the agency's authority. However, the court ruled that the FDA could require a premarket review submission for a product quantity change, as such a change would constitute a "new" tobacco product.

The FDA Tobacco Act grants the FDA the authority to impose broad additional restrictions. On a going forward basis, the FDA:

- will require manufacturers to test ingredients and constituents identified by the FDA and disclose this information to the public;
- will prohibit use of tobacco containing a pesticide chemical residue at a level greater than allowed under Federal law;
- will establish "good manufacturing practices" to be followed at tobacco manufacturing facilities;
- may place more severe restrictions on the advertising, marketing and sale of tobacco products; and
- may require the reduction of nicotine and the reduction or elimination of other constituents, as further discussed below.

Pursuant to the foregoing authority, the FDA has proposed a rule that, if adopted, would require the reduction, over a three-year period, of the levels of N-nitrosonornicotine (NNN) contained in smokeless tobacco products. The adoption of this proposed rule is currently suspended by virtue of a federal regulatory freeze imposed by the U.S. President. In addition, on July 28, 2017, the FDA announced its intention to issue an ANPRM to seek input on the potential public health benefits and any possible adverse effects of lowering nicotine in combustible cigarettes to 'non-addictive' levels.

If the proposed rule on NNN-reduction (either in its current form or in a form substantially similar to its current form) or restrictive rules on nicotine reduction are adopted, management expects that compliance or the inability to comply could have a material adverse effect on the results of operations, cash flows and financial position of American Snuff and RAI.

The U.S. Congress did limit the FDA's authority in two areas, prohibiting it from:

- banning all tobacco products; and
- requiring the reduction of nicotine yields of a tobacco product to zero.

In 2009, a "Center for Tobacco Products", referred to as the CTP, was established within the FDA, funded through quarterly user fees that are assessed against tobacco product manufacturers and importers based on market share. The total amount of user fees to be collected over the first ten years will be approximately $5.4 billion.

Within the CTP, a Tobacco Products Scientific Advisory Committee, referred to as the TPSAC, was established on March 22, 2010, to provide advice, information and recommendations with respect to the safety, dependence or health issues related to tobacco products. The TPSAC is scheduled to meet periodically to address matters brought to it by the CTP as well as those required of it by the FDA Tobacco Act, including:

- a recommendation on modified risk applications;
- a recommendation as to whether there is a threshold level below which nicotine yields do not produce dependence;
- a report on the impact of the use of menthol in cigarettes on the public health; and
- a report on the impact of dissolvable tobacco products on the public health.

Potential Regulation of Menthol

At a meeting held on March 18, 2011, the TPSAC presented its final report on the use of menthol, which concluded that removal of menthol cigarettes from the marketplace would benefit public health in the United States. On July 24, 2013, the FDA issued a report detailing its own preliminary scientific evaluation of public health issues related to the use of menthol in cigarettes, including a determination that there is likely a public health impact of menthol in cigarettes. The FDA's report found that the weight of the evidence supports the conclusion that menthol in cigarettes is associated with:

- increased initiation among youth and young adults;
- reduced success in smoking cessation; and
- increased dependence.

The report found that menthol in cigarettes is not associated with:

- increased smoke toxicity;
- increased levels of biomarkers of exposure; or
- increased disease risk.

The FDA concurrently published in the *Federal Register* an ANPRM to obtain information related to the potential regulation of menthol in cigarettes. The ANPRM sought comments from interested stakeholders on the FDA's preliminary evaluation, as well as any data, research, or other information on various topics, including, but not limited to:

- potential product standards for menthol and the potential period for compliance with such standards;
- potential restrictions on the sale and/or distribution of menthol products; and
- evidence regarding illicit trade in menthol cigarettes (including the public health impact thereof) should the use of menthol in cigarettes be restricted or banned.

In November 2013, RAI's operating companies submitted comments on the ANPRM. The FDA will evaluate all comments it has received from interested stakeholders in response to the ANPRM, as the agency considers whether to require additional standards or restrictions with respect to menthol cigarettes. In the meantime, on July 28, 2017, the FDA confirmed that it would issue a further ANPRM to seek public comment on the role that flavors (including menthol) in tobacco products play in attracting youth and may play in helping some smokers switch to potentially less harmful forms of nicotine delivery. The FDA Tobacco Act does not require the FDA to adopt any such standards or restrictions. Any rule that the FDA may propose will be subject to a 60-day comment period, and may only become effective at least one year after the rule's adoption. If the FDA were to adopt a rule banning or severely restricting the use of menthol in cigarettes, such rule could have an adverse effect on the sale of RAI's subsidiaries' products containing menthol and, as a result, on the results of operations, cash flows and financial position of RAI.

On February 25, 2011, RJR Tobacco Company, Lorillard and Lorillard Tobacco jointly filed in the U.S. District Court for the District of Columbia a lawsuit, *Lorillard, Inc. v. U.S. Food and Drug Administration*, challenging the composition of the TPSAC. For additional information concerning this case, see "— *Litigation*

Affecting the Cigarette Industry — Other Litigation and Developments — FDA Litigation" in note 13 to the RAI Group's consolidated financial statements included in this Offering Memorandum. In addition to the potential regulation of menthol in cigarettes by the FDA, certain municipalities either have adopted, or are considering the adoption of, a ban on the sale of menthol cigarettes. For instance, on June 27, 2017, the San Francisco Board of Supervisors unanimously voted to amend that city's Health Code to prohibit tobacco retailers from selling flavored tobacco products, including flavored e-cigarettes and menthol cigarettes. Use and possession of flavored tobacco products are not impacted by the ban. The ordinance will go into effect on April 1, 2018.

At a meeting on March 1, 2012, the TPSAC presented to the FDA its final report and recommendations with respect to dissolvable tobacco products. The FDA will consider the report and recommendations and determine what future action, if any, is warranted with respect to dissolvable tobacco products. There is no timeline or statutory requirement for the FDA to act on the TPSAC's recommendations.

On July 28, 2017, the FDA announced its intention to issue an ANPRM to seek input on the potential public health benefits and any possible adverse effects of lowering nicotine in combustible cigarettes to 'non-addictive' levels. Although it is not possible to predict whether or when the FDA will take action, the FDA, or another governmental authority, may seek to adopt regulations banning or severely restricting the use of menthol in tobacco products, the sale of menthol cigarettes or limiting nicotine yields in the United States.

Final Deeming Regulation

On May 10, 2016, the FDA issued a final regulation, referred to as the Final Rule, deeming all products that meet the FDA Tobacco Act's definition of "tobacco product" to be subject to the FDA's regulatory authority under the FDA Tobacco Act. The Final Rule became effective as of August 8, 2016, though each requirement of the Final Rule has its own compliance date. Such newly 'deemed' tobacco products subject to the FDA Tobacco Act include, among others, electronic nicotine delivery systems (including e-cigarettes, e-hookah, e-cigars, vape pens, advanced refillable personal vaporizers, electronic pipes and e-liquids mixed in vape shops), certain dissolvable tobacco products, cigars, and pipe tobacco. In addition, "components" and "parts" (e.g., batteries), but not "accessories" (e.g., lighters, pipe pouches), of newly deemed products are themselves subject to the FDA Tobacco Act by virtue of the Final Rule.

Deemed products are subject to the provisions of the FDA Tobacco Act to which currently regulated tobacco products have been subject since the FDA Tobacco Act's adoption in 2009, including: adulteration and misbranding provisions; requirements relating to ingredient listing and reporting of harmful and potentially harmful constituents; registration of tobacco product manufacturing establishments and product listing; restrictions against the sale and distribution of products with modified risk descriptions (such as use of "light," "low," and "mild"); prohibition on the distribution of free samples; a required health warning; and, as described in more detail below, premarket review requirements.

The "grandfather" date under the Final Rule for newly deemed products remains the same as the "grandfather" date for those tobacco products already subject to the FDA Tobacco Act – February 15, 2007. Any tobacco product that was not legally marketed as of February 15, 2007, will be considered a new tobacco product subject to premarket review by the FDA.

The FDA has recognized that few, if any, e-cigarettes were on the market as of February 15, 2007, but thousands of such products (including RJR Vapor's VUSE Digital Vapor Cigarette) subsequently have entered into commerce. To address this issue, the FDA established a compliance policy regarding the premarket review requirements for all newly deemed tobacco products that are not grandfathered products, but were on the market as of August 8, 2016. The FDA will allow such products to remain on the market so long as the manufacturer has filed the appropriate premarket review application by a specific deadline. The Final Rule established staggered initial compliance periods based on the expected complexity of the applications to be submitted. On May 3, 2017, the FDA issued a revised compliance policy, extending these periods by three months, and providing for the following submission deadlines: Substantial Equivalence Exemption Report — November 8, 2017; Substantial Equivalence Report — May 8, 2018; and Premarket Tobacco Product Application ("PMTA")— November 8, 2018. However, on July 28, 2017, the FDA announced its intention to extend the deadline for filing these applications until August 8, 2021 for newly regulated combustible products and until August 8, 2022 for newly-regulated non-combustible products.

During the third quarter of 2016, and prior to August 8, 2016, RJR Vapor introduced into the market additional newly deemed tobacco products. RJR Vapor intends to file a PMTA with respect to VUSE and certain other of its e-cigarette products. Further, RJR Vapor believes that substantially all other e-cigarette manufacturers likewise will be unable to use the substantial equivalence pathway to obtain FDA clearance of their respective e-cigarettes, but instead, will be required to file PMTAs to obtain FDA clearance of such products. Based on the

FDA's draft guidance setting forth the type of evidence that must be included within a premarket review application, RJR Vapor expects the costs of preparing a PMTA to be significant, and a cost more easily borne by larger manufacturers.

In order for the FDA to clear a PMTA covering an e-cigarette, the applicant must show that the marketing of such e-cigarette would be appropriate for the protection of the public health. Under the FDA Tobacco Act, whether a tobacco product is appropriate for the protection of the public health is to be determined "…with respect to the risks and benefits to the population as a whole, including users and nonusers of the tobacco product, and taking into account — (A) the increased or decreased likelihood that existing users of tobacco products will stop using such products; and (B) the increased or decreased likelihood that those who do not use tobacco products will start using such products." In draft guidance issued by the FDA, the agency has stated that to completely assess whether a PMTA shows that a product is appropriate for the protection of the public health, the "FDA will look at the product in the context of the current tobacco product market. FDA can do this by understanding the spectrum of risk of currently available tobacco products and assessing the new product within that spectrum." At present, there is substantial uncertainty over how the FDA will apply the foregoing principles in practice when determining whether to clear an e-cigarette PMTA. To date, few PMTAs have been filed, and the only PMTAs that the FDA has cleared relate to snus products of another manufacturer.

As part of its compliance policy, the FDA has previously stated that for any product for which the appropriate premarket review application has been timely filed, the manufacturer may continue to market the product for an additional year from the deadline for filing the appropriate application while the FDA reviews the application. If the FDA rejects the premarket review application (even if the rejection occurs prior to the end of the one-year period), then the manufacturer must immediately remove that product from commerce. At the end of the one-year compliance period, if the product has not yet been given market authorization, the Final Rule authorizes the FDA to take enforcement action. However, if review of a pending premarket review application is substantially complete and the manufacturer has provided all required information, then the FDA may defer enforcement for a reasonable time period on a case-by-case basis. As part of the FDA's announcement on July 28, 2017, it confirmed that it expects that manufacturers will continue to market products while the FDA reviews product applications. For deemed products that were not on the market as of August 8, 2016, the above compliance policy does not apply and, instead, manufacturers must file the appropriate premarket review application and obtain FDA clearance before marketing such product.

FDA Warning Letter to SFNTC

On August 27, 2015, the FDA sent a warning letter to SFNTC claiming that SFNTC's use of the terms "Natural" and "Additive Free" in the product labeling and advertising for Natural American Spirit cigarettes violates the Modified Risk Tobacco Products provision of the FDA Tobacco Act. Following discussions between the parties, on January 23, 2017, the FDA and SFNTC reached an agreement whereby, among other things, SFNTC committed to phasing out use of the terms "Natural" and "Additive Free" from product labeling and advertising for Natural American Spirit cigarettes on an established timeframe. The agreement also specifies that SFNTC may continue to use the term "Natural" in the Natural American Spirit brand name and trademarks. SFNTC's scheduled deletion of the terms "Natural" and "Additive Free" from the labeling and advertising of its Natural American Spirit cigarettes could have an adverse effect on the sale of such cigarettes and, as a result, on the results of operations, cash flows and financial position of SFNTC and RAI .

Premarket Review; MRTP Applications

RAI's strategy of focusing on innovation to help transform the tobacco industry is dependent on its operating companies' ability to introduce new products into the market. For a manufacturer to launch a new product or modify an existing one after March 22, 2011, the FDA Tobacco Act requires a manufacturer to file one of three types of product applications (a new product application, a substantial equivalence application or a substantial equivalence exemption application) with the CTP, depending on the type and level of change being sought. In all cases, however, the manufacturer may not market the new or modified product in the United States until the CTP issues a marketing order, allowing the product to be marketed. Although the FDA Tobacco Act has now been in effect for more than six years, uncertainty remains as to the timing of the review and the requirements for clearance of new or modified tobacco products introduced in the market after March 22, 2011. These uncertainties, in conjunction with the clearance requirement itself, could have an adverse impact on the ability of RAI's operating companies to innovate in the future.

Similarly, a manufacturer that introduced a new tobacco product or modified a tobacco product between February 15, 2007 and March 22, 2011, was required to file a substantial equivalence report with the CTP, demonstrating either (1) that the new or modified product had the same characteristics as a product commercially

available as of February 15, 2007, referred to as a predicate product, or (2) if the new or modified product had different characteristics than the predicate product, that it did not raise different questions of public health. A product subject to such report is referred to as a provisional product. A manufacturer may continue to market a provisional product unless and until the CTP issues an order that the provisional product is not substantially equivalent, in which case the FDA could then require the manufacturer to remove the provisional product from the market. On September 15, 2015, the CTP issued four Not Substantially Equivalent orders, referred to as NSE orders, to RJR Tobacco Company, determining that four cigarette styles are not substantially equivalent to their respective predicate products, and ordering that RJR Tobacco immediately stop all distribution, importation, sale, marketing and promotion of these provisional products. On September 29, 2015, RJR Tobacco Company provided the FDA with a compliance plan with respect to these NSE orders. On January 20, 2016, RJR Tobacco Company received notification from the CTP's Office of Compliance and Enforcement that no further action was necessary on the compliance plan.

As with new or modified tobacco products introduced after March 22, 2011, uncertainty remains over the timing of review of substantial equivalence reports for provisional products. Indeed, on July 28, 2017, the FDA announced plans to issue foundational rules with the aim of making the product review process more efficient, predictable and transparent for manufacturers, but which may in fact add to the complexity of the submission process. For example, among other things, the FDA intends to issue regulations outlining what information the agency expects to be included in PMTAs, Modified Risk Tobacco Product ("MRTP") applications and reports to demonstrate substantial equivalence. The FDA also plans to finalize guidance on how it intends to review PMTAs for electronic nicotine delivery systems.

Although the sales of the provisional products subject to the NSE orders described in the preceding paragraph are not material to RJR Tobacco Company, substantially all of RAI's operating companies' products currently on the market are provisional products. If the CTP were to issue NSE orders with respect to other provisional products of RAI's operating companies, such orders, if not withdrawn or invalidated, would have a material adverse impact on the sales of the products subject to the orders, and could have an adverse impact on the results of operations, cash flows and financial position of RAI.

Other Matters

All 50 states and a large number of local jurisdictions have introduced or enacted legislation imposing various restrictions on public smoking. Additionally, many employers have initiated programs restricting or eliminating smoking in the workplace. A number of states have enacted legislation designating a portion of increased cigarette excise taxes to fund anti-smoking programs, health-care programs or cancer research. In addition, educational and research programs addressing health-care issues related to smoking are being funded from industry payments made or to be made under settlements with state attorneys general. Federal law prohibits smoking in scheduled passenger aircraft, and the U.S. Interstate Commerce Commission has banned smoking on interstate passenger buses. Certain common carriers have imposed additional restrictions on passenger smoking.

In July 2007, the State of Maine became the first state to enact a statute that prohibits the sale of cigarettes and cigars that have a characterizing flavor. The legislation defines characterizing flavor as "a distinguishable taste or aroma that is imparted to tobacco or tobacco smoke either prior to or during consumption, other than a taste or aroma from tobacco, menthol, clove, coffee, nuts or peppers." As of December 31, 2016, New Jersey was the only other state that had adopted a statute banning the sale of cigarettes containing certain characterizing flavors; the New Jersey statute exempts menthol from the prohibition. Since Maine's adoption of such legislation, numerous counties and municipalities have adopted laws prohibiting or restricting the sale of certain tobacco products containing "characterizing flavors." The scope of these laws varies from jurisdiction to jurisdiction; for example, some, but not all, of these laws exempt menthol from the definition of a "characterizing flavor," and certain laws apply to tobacco products other than cigarettes. The "characterizing flavor" ordinances in New York City, and Providence, Rhode Island were each challenged on the grounds, among others, that the FDA Tobacco Act preempts such local laws. The U.S. Courts of Appeals for the Second Circuit and First Circuit have held that the FDA Tobacco Act does not preempt the New York City and Providence, Rhode Island ordinances, respectively. Moreover, on July 28, 2017, the FDA confirmed that it would issue an ANPRM to seek public comment on the role that flavors (including menthol) in tobacco products play in attracting youth and may play in helping some smokers switch to potentially less harmful forms of nicotine delivery.

A price differential (principally resulting from different tax rates) exists between tobacco products manufactured for sale abroad and tobacco products manufactured for sale in the United States. Consequently, a market has developed for tobacco products manufactured for sale abroad, but instead diverted for sale in the United States at prices substantially lower than tobacco products produced for sale in the United States. Furthermore, within the United States, tobacco products are often purchased in states having low excise taxes and

then resold illegally in states having higher excise taxes. These smuggling activities are often conducted by criminal organizations on a large scale. The sale of diverted or smuggled tobacco products is unlawful, and facilitates the sale of tobacco products to underage persons — undermining a key objective of RAI and its operating companies to prevent youth access to tobacco products. In addition, smuggling activities adversely impact the sale of tobacco products by RAI's operating companies by: disrupting the contractual relationships between RAI's operating companies and their wholesalers and retailers; damaging the equity of the brands sold by RAI's operating companies in terms of the pricing and positioning of those brands; injuring the reputation of RAI's operating companies by wrongly associating their brands with illegal smuggling activity; and making it difficult for retailers located in high tax jurisdictions to sell the products of RAI's operating companies, given the competitive price advantage that smuggled products have in such jurisdictions. RAI undertakes a variety of actions to help combat illicit trade in tobacco products, including (1) promoting greater awareness among government officials, law enforcement and the public of the problem, (2) supporting law enforcement investigations of illicit trade in tobacco products, and (3) supporting legislative efforts to increase both the enforcement of anti-illicit trade laws and the penalties for the violations of such laws.

RJR Tobacco Company expects to benefit from certain state legislative activity aimed at leveling the playing field between PMs under the MSA and "nonparticipating manufacturers" under the MSA, referred to as NPMs. Forty-six states have passed legislation to ensure NPMs are making required escrow payments. Under this legislation, a state would only permit distribution of brands by manufacturers who are deemed by the states to be MSA-compliant or that are making required escrow payments. Failure to make escrow payments could result in the loss of an NPM's ability to sell tobacco products in a respective state.

Additionally, 45 states have enacted legislation that closes a loophole in the MSA. The loophole allows NPMs that concentrate their sales in a single state, or a limited number of states, to recover most of the funds from their escrow accounts. To obtain the refunds, the manufacturers must establish that their escrow deposit was greater than the amount the state would have received had the manufacturer been a "subsequent participating manufacturer" under the MSA, that is, the state's "allocable share." The National Association of Attorneys General, referred to as NAAG, has endorsed adoption of the allocable share legislation needed to eliminate this loophole.

Forty-two states by statute or court rule have limited, in at least some circumstances, the amount of the bond required to stay execution of an adverse judgment pending an appeal in state court. The limitation on the amount of such bonds ranges generally from $1 million to $150 million. In five states and Puerto Rico, the filing of a notice of appeal automatically stays the judgment of the trial court. For information regarding the bonding requirements applicable to *Engle* Progeny cases, see "*— Litigation Affecting the Cigarette Industry — Engle and Engle Progeny Cases*" in note 13 to the RAI Group's consolidated financial statements included in this Offering Memorandum.

In 2003, the World Health Organization adopted a broad tobacco-control treaty, the Framework Convention on Tobacco Control, which entered into force in February 2005. The treaty recommends and requires enactment of legislation establishing specific actions to prevent youth smoking, restrict and gradually eliminate tobacco products marketing, provide greater regulation and disclosure of ingredients, increase the size and scope of package warning labels to cover at least 30% of each package and include graphic pictures on packages. The United States was an original signatory to the treaty. The treaty, however, has not been referred to, or ratified by, the U.S. Senate and, as a result, the United States is not a party to the treaty. Ratification of the treaty by the United States could lead to broader regulation of the industry.

On March 31, 2017, RJR Tobacco Company filed with the FDA MRTP applications, covering six styles of Camel Snus. In accordance with the FDA's submission guidelines and in support of its MRTP applications, RJR Tobacco Company provided the FDA documentation regarding the results and analysis from a number of scientific studies. The FDA initially will review the applications to determine whether to accept them for substantive review; the FDA may ask RJR Tobacco Company to provide additional information before the agency accepts the applications for review. If the FDA ultimately accepts the applications, then the agency will undertake a scientific review to determine whether (and will grant a modified risk tobacco product order only if) RJR Tobacco Company has demonstrated that the products subject to the applications will (1) significantly reduce the risk of tobacco-related disease to the users of the products and (2) benefit the health of the population as a whole. There is no deadline by which the FDA is required to make a determination with respect to RJR Tobacco Company's MRTP applications. If the FDA were to issue a modified risk tobacco product order, then RJR Tobacco Company would have the ability to communicate the reduced risk claims contained in the approved MRTP applications. To date, the FDA has not granted a modified risk tobacco product order to any manufacturer.

The FDA Tobacco Act could result in a decrease in cigarette, smokeless tobacco product and e-cigarette sales in the United States, including sales of RJR Tobacco Company's, SFNTC's, American Snuff Co.'s and RJR Vapor's brands, that, together with increased costs incurred by RAI's operating companies arising from the FDA Tobacco Act, could have a material adverse effect on RAI's financial condition, results of operations and cash flows. It is not possible to determine what additional federal, state or local legislation or regulations relating to smoking or cigarettes will be enacted or to predict the effect of new legislation or regulations on RJR Tobacco Company, SFNTC or the cigarette industry in general, but any new legislation or regulations could have an adverse effect on RJR Tobacco Company, SFNTC or the cigarette industry in general. Similarly, it is not possible to determine what additional federal, state or local legislation or regulations relating to smokeless tobacco products or e-cigarettes will be enacted or to predict the effect of new regulations on American Snuff Co. or smokeless tobacco products in general, or on RJR Vapor or e-cigarettes in general, as the case may be, but any new legislation or regulations could have an adverse effect on American Snuff Co. or smokeless tobacco products in general or on RJR Vapor or e-cigarettes in general, as the case may be.

Legal Proceedings

Tobacco Litigation — General

Introduction

Litigation, claims, and other legal proceedings relating to the use of, exposure to, or purchase of tobacco products are pending or may be instituted in the future against RJR Tobacco Company (including as successor by merger to Lorillard Tobacco), American Snuff Co., SFNTC, RJR Vapor, RAI, Lorillard, other RAI affiliates, and indemnitees (including but not limited to B&W), sometimes referred to collectively as Reynolds Defendants. These pending legal proceedings include claims relating to cigarette products manufactured by RJR Tobacco Company, Lorillard Tobacco, SFNTC or certain of their affiliates or indemnitees, smokeless tobacco products manufactured by American Snuff Co., and e-cigarette products manufactured on behalf of and marketed by RJR Vapor. A discussion of the legal proceedings relating to cigarette products (and e-cigarettes) is set forth below under the heading "— *Litigation Affecting the Cigarette Industry*." All of the references under that heading to tobacco-related litigation, smoking and health litigation and other similar references are references to legal proceedings relating to cigarette products or e-cigarettes, as the case may be, and are not references to legal proceedings involving smokeless tobacco products, and case numbers under that heading include only cases involving cigarette products and e-cigarettes. The legal proceedings relating to the smokeless tobacco products manufactured by American Snuff Co. are discussed separately under the heading "— *Smokeless Tobacco Litigation*" below.

In connection with the B&W business combination, RJR Tobacco Company undertook certain indemnification obligations with respect to B&W and its affiliates, including its indirect parent, BAT. As a result of the merger, these indemnification obligations are now intercompany obligations. See "— *Litigation Affecting the Cigarette Industry — Overview — Introduction*" below. In connection with the Lorillard merger and the Lorillard Divestiture, as applicable, RAI and RJR Tobacco Company undertook certain indemnification obligations. See "— *Litigation Affecting the Cigarette Industry — Overview — Introduction*," "— *Other Contingencies — ITG Indemnity*," and "— *Other Contingencies — Loews Indemnity*" below. In addition, in connection with the sale of the non-U.S. operations and business of the Natural American Spirit brand, various subsidiaries have agreed to indemnify the buyer for certain claims. See "— *Other Contingencies — JTI Indemnities*" below.

Certain Terms and Phrases

Certain terms and phrases used in this footnote may require some explanation. The term "judgment" or "final judgment" refers to the final decision of the court resolving the dispute and determining the rights and obligations of the parties. At the trial court level, for example, a final judgment generally is entered by the court after a jury verdict and after post-verdict motions have been decided. In most cases, the losing party can appeal a verdict only after a final judgment has been entered by the trial court.

The term "damages" refers to the amount of money sought by a plaintiff in a complaint, or awarded to a party by a jury or, in some cases, by a judge. "Compensatory damages" are awarded to compensate the prevailing party for actual losses suffered, if liability is proved. In cases in which there is a finding that a defendant has acted willfully, maliciously or fraudulently, generally based on a higher burden of proof than is required for a finding of liability for compensatory damages, a plaintiff also may be awarded "punitive damages." Although damages may be awarded at the trial court stage, a losing party generally may be protected from paying any damages until all appellate avenues have been exhausted by posting a supersedeas bond. The amount of such a

bond is governed by the law of the relevant jurisdiction and generally is set at the amount of damages plus some measure of statutory interest, modified at the discretion of the appropriate court or subject to limits set by a court or statute.

The term "*per curiam*" refers to a decision entered by an appellate court that is not signed by an individual judge. In most cases, it is used to indicate that the opinion entered is a brief announcement of the court's decision and is not accompanied by an opinion explaining the court's reasoning.

The term "settlement" refers to certain types of cases in which cigarette manufacturers, including RJR Tobacco Company, B&W and Lorillard Tobacco, have agreed to resolve disputes with certain plaintiffs without resolving the cases through trial. The principal terms of certain settlements entered into by RJR Tobacco Company, B&W and Lorillard Tobacco are explained below under "— *Accounting for Tobacco-Related Litigation Contingencies*."

Theories of Recovery

The plaintiffs seek recovery on a variety of legal theories, including negligence, strict liability in tort, design defect, failure to warn, fraud, misrepresentation, violations of unfair and deceptive trade practices statutes, conspiracy, medical monitoring and violations of state and federal antitrust laws. In certain of these cases, the plaintiffs claim that cigarette smoking exacerbated injuries caused by exposure to asbestos or, in the case of certain claims asserted against Lorillard Tobacco, that they were injured by exposure to filters containing asbestos used in one cigarette brand for roughly four years before 1957, the latter cases referred to as Filter Cases.

The plaintiffs seek various forms of relief, including compensatory and, where available, punitive damages, treble or multiple damages and statutory damages and penalties, creation of medical monitoring and smoking cessation funds, disgorgement of profits, and injunctive and other equitable relief. Although alleged damages often are not determinable from a complaint, and the law governing the pleading and calculation of damages varies from jurisdiction to jurisdiction, compensatory and punitive damages have been specifically pleaded in a number of cases, sometimes in amounts ranging into the hundreds of millions and even billions of dollars.

Defenses

The defenses raised by Reynolds Defendants include, where applicable and otherwise appropriate, preemption by the Federal Cigarette Labeling and Advertising Act of some or all claims arising after 1969, or by the Comprehensive Smokeless Tobacco Health Education Act for claims arising after 1986, the lack of any defect in the product, assumption of the risk, contributory or comparative fault, lack of proximate cause, remoteness, lack of standing, statutes of limitations or repose and others. RAI, R.J. Reynolds Tobacco Holdings, Inc and Lorillard have asserted additional defenses, including jurisdictional defenses, in many of the cases in which they are named.

Accounting for Tobacco-Related Litigation Contingencies

In accordance with U.S. GAAP, RAI and its subsidiaries record any loss concerning litigation at such time as an unfavorable outcome becomes probable and the amount can be reasonably estimated on an individual case-by-case basis. For the reasons set forth below, RAI's management continues to conclude that the loss of any particular pending tobacco-related litigation claim against the Reynolds Defendants, when viewed on an individual basis, is not probable, except for certain *Engle* Progeny cases noted below.

Reynolds Defendants believe that they have valid defenses to the tobacco-related litigation claims against them, as well as valid bases for appeal of adverse verdicts against them. Reynolds Defendants have, through their counsel, filed pleadings and memoranda in pending tobacco-related litigation that set forth and discuss a number of grounds and defenses that they and their counsel believe have a valid basis in law and fact. With the exception of the *Engle* Progeny cases described below, Reynolds Defendants continue to win the majority of tobacco-related litigation claims that reach trial, and a very high percentage of the tobacco-related litigation claims brought against them, including *Engle* Progeny cases, continue to be dismissed at or before trial. Based on their experience in tobacco-related litigation and the strength of the defenses available to them in such litigation, Reynolds Defendants believe that their successful defense of tobacco-related litigation in the past will continue in the future.

RAI's unaudited condensed consolidated balance sheet as of June 30, 2017, included in this Offering Memorandum, contains accruals for the following *Engle* Progeny cases: *Starr-Blundell, Monroe, Lourie, Lewis, Block* and *Ward* (for attorneys' fees and interest only with respect to *Ward*). In the first quarter of 2017, RJR Tobacco Company paid approximately $42.8 million in satisfaction of the judgment, including attorneys' fees and interest, in *Buonomo*. In the second quarter of 2017, RJR Tobacco Company paid approximately $3.5 million in satisfaction of the judgment, including attorneys' fees and interest, in *Lawrence* and attorneys' fees and

interest in *Buonomo*. Other accruals include an amount for the estimated costs of the corrective communications in the *U.S. Department of Justice* case. As other cases proceed through the appellate process, RAI will evaluate the need for further accruals on an individual case-by-case basis if an unfavorable outcome becomes probable and the amount can be reasonably estimated.

It is the policy of Reynolds Defendants to defend tobacco-related litigation claims vigorously; generally, Reynolds Defendants and indemnitees do not settle such claims. However, Reynolds Defendants may enter into settlement discussions in some cases, if they believe it is in their best interests to do so. Exceptions to this general approach include, but are not limited to, actions taken pursuant to "offer of judgment" statutes, as described below in "*— Litigation Affecting the Cigarette Industry — Overview*," and Filter Cases, as described below in "*— Litigation Affecting the Cigarette Industry — Filter Cases*," as well as other historical examples discussed below.

With respect to smoking and health tobacco litigation claims, the only significant settlements reached by RJR Tobacco Company, Lorillard Tobacco and B&W involved:

- the State Settlement Agreements and the funding by various tobacco companies of a $5.2 billion trust fund contemplated by the MSA to benefit tobacco growers;
- the original *Broin* flight attendant case discussed below under "*— Litigation Affecting the Cigarette Industry — Broin II Cases*," and
- most of the *Engle* Progeny cases pending in federal court, after the initial docket of over 4,000 such cases was reduced to approximately 400 cases.

The circumstances surrounding the State Settlement Agreements and the funding of a trust fund to benefit the tobacco growers are readily distinguishable from the current categories of tobacco-related litigation claims involving Reynolds Defendants. In the claims underlying the State Settlement Agreements, the states sought to recover funds paid for health care and medical and other assistance to state citizens suffering from diseases and conditions allegedly related to tobacco use. The State Settlement Agreements settled all the health-care cost recovery actions brought by, or on behalf of, the settling jurisdictions and contain releases of various additional present and future claims. In accordance with the MSA, various tobacco companies agreed to fund a $5.2 billion trust fund to be used to address the possible adverse economic impact of the MSA on tobacco growers. A discussion of the State Settlement Agreements, and a table depicting the related payment schedule, is set forth below under "*— Litigation Affecting the Cigarette Industry — Health-Care Cost Recovery Cases*."

As with claims that were resolved by the State Settlement Agreements, the other cases settled by RJR Tobacco Company can be distinguished from existing cases pending against the Reynolds Defendants. The original *Broin* case, discussed below under "*— Litigation Affecting the Cigarette Industry — Broin II Cases*," was settled in the middle of trial during negotiations concerning a possible nation-wide settlement of claims similar to those underlying the State Settlement Agreements.

The federal *Engle* Progeny cases likewise presented exceptional circumstances not present in the state *Engle* Progeny cases or elsewhere. All of the federal *Engle* Progeny cases subject to the settlement were pending in the same court, were coordinated by the same judge, and involved the same sets of plaintiffs' lawyers. Moreover, RJR Tobacco Company settled only after approximately 90% of the federal *Engle* Progeny cases otherwise had been resolved. A discussion of the *Engle* Progeny cases and the settlement of the federal *Engle* Progeny cases is set forth below under "*— Litigation Affecting the Cigarette Industry — Engle and Engle Progeny Cases*."

In 2010, RJR Tobacco Company entered into a comprehensive agreement with the Canadian federal, provincial and territorial governments, which resolved all civil claims related to the movement of contraband tobacco products in Canada during the period 1985 through 1999 that the Canadian governments could assert against RJR Tobacco Company and its affiliates. These claims involved different theories of recovery than the other tobacco-related litigation claims pending against the Reynolds Defendants.

Also, in 2004, RJR Tobacco Company and B&W separately settled the antitrust case *DeLoach v. Philip Morris Cos., Inc.,* which was brought by a unique class of plaintiffs: a class of all tobacco growers and tobacco allotment holders. The plaintiffs asserted that the defendants conspired to fix the price of tobacco leaf and to destroy the federal government's tobacco quota and price support program. Despite legal defenses they believed to be valid, RJR Tobacco Company and B&W separately settled this case to avoid a long and contentious trial with the tobacco growers. The *DeLoach* case involved different types of plaintiffs and different theories of recovery under the antitrust laws than the other tobacco-related litigation claims pending against the Reynolds Defendants.

Finally, as discussed under "*— Litigation Affecting the Cigarette Industry — State Settlement Agreements — Enforcement and Validity; Adjustments*," RJR Tobacco Company, B&W and Lorillard Tobacco each has

settled certain cases brought by states concerning the enforcement of State Settlement Agreements. Despite legal defenses believed to be valid, these cases were settled to avoid further contentious litigation with the states involved. These enforcement actions involved alleged breaches of State Settlement Agreements based on specific actions taken by particular defendants. Accordingly, any future enforcement actions involving State Settlement Agreements will be reviewed by RJR Tobacco Company on the merits and should not be affected by the settlement of prior enforcement cases.

Cautionary Statement

Even though RAI's management continues to believe that the loss of particular pending tobacco-related litigation claims against Reynolds Defendants, when viewed on an individual case-by-case basis, is not probable or estimable (except for certain *Engle* Progeny cases described below), the possibility of material losses related to such litigation is more than remote. Litigation is subject to many uncertainties, and generally, it is not possible to predict the outcome of any particular litigation pending against Reynolds Defendants, or to reasonably estimate the amount or range of any possible loss.

Although Reynolds Defendants believe that they have valid bases for appeals of adverse verdicts in their pending cases and valid defenses to all actions and intend to defend them vigorously as described above, it is possible that there could be further adverse developments in pending cases, and that additional cases could be decided unfavorably against Reynolds Defendants. Determinations of liability or adverse rulings in such cases or in similar cases involving other cigarette manufacturers as defendants, even if such judgments are not final, could have a material adverse effect on the litigation against Reynolds Defendants and could encourage the commencement of additional tobacco-related litigation. Reynolds Defendants also may enter into settlement discussions in some cases, if they believe it is in their best interests to do so. In addition, a number of political, legislative, regulatory and other developments relating to the tobacco industry and cigarette smoking have received wide media attention. These developments may negatively affect the outcomes of tobacco-related legal actions and encourage the commencement of additional similar litigation.

Although it is impossible to predict the outcome of such events on pending litigation and the rate new lawsuits may be filed against Reynolds Defendants, a significant increase in litigation or in adverse outcomes for tobacco defendants, or difficulties in obtaining the bonding required to stay execution of judgments on appeal, could have a material adverse effect on any or all of these entities. Moreover, notwithstanding the quality of defenses available to Reynolds Defendants in litigation matters, it is possible that RAI's results of operations, cash flows or financial position could be materially adversely affected by the ultimate outcome of certain pending litigation or future claims against Reynolds Defendants.

Litigation Affecting the Cigarette Industry

Overview

Introduction

In connection with the B&W business combination, RJR Tobacco Company agreed to indemnify B&W and its affiliates against, among other things, certain litigation liabilities, costs and expenses incurred by B&W or its affiliates arising out of the U.S. cigarette and tobacco business of B&W. Also, in connection with the Lorillard merger, Lorillard Tobacco was merged into RJR Tobacco Company with RJR Tobacco Company being the surviving entity, Lorillard Tobacco ceasing to exist, and RJR Tobacco Company succeeding to Lorillard Tobacco's liabilities, including Lorillard Tobacco's litigation liabilities, costs and expenses, referred to as the Lorillard Tobacco Merger. Although Lorillard Tobacco no longer exists as a result of the Lorillard Tobacco Merger, it will remain as a named party in cases pending on the date of the Lorillard Tobacco Merger until courts grant motions to substitute RJR Tobacco Company for Lorillard Tobacco or the claims are dismissed. The cases discussed below include cases brought against RJR Tobacco Company, Lorillard Tobacco and their affiliates and indemnitees, including RAI, R.J. Reynolds Tobacco Holdings, Inc., B&W and Lorillard. Cases brought against SFNTC and RJR Vapor also are discussed.

During the first six months of 2017, 63 tobacco-related cases were served against Reynolds Defendants. On June 30, 2017, there were, subject to the exclusions described immediately below, 249 cases pending against Reynolds Defendants: 232 in the United States and 17 in Canada, as compared with 286 total cases on June 30, 2016. Of the U.S. cases pending on June 30, 2017, 37 are pending in federal court, 194 in state court and one in tribal court, primarily in the following states: Illinois (51 cases); Massachusetts (35 cases); Florida (29 cases); New York (18 cases); Missouri (16 cases); New Mexico (16 cases); and Louisiana (10 cases). The U.S. case number excludes the approximately 564 individual smoker cases pending in West Virginia state court as a

consolidated action, 2,694 *Engle* Progeny cases, involving approximately 3,492 individual plaintiffs, and 2,346 *Broin II* cases, pending in the United States against RJR Tobacco Company, Lorillard Tobacco or certain other Reynolds Defendants.

The following table lists the categories of the U.S. tobacco-related cases pending against Reynolds Defendants as of June 30, 2017, and the increase or decrease from the number of cases pending against Reynolds Defendants as of March 31, 2017, as reported in RAI's Quarterly Report on Form 10-Q for the fiscal quarter ended March 31, 2017, filed with the U.S. Securities and Exchange Commission on May 3, 2017, and a cross-reference to the discussion of each case type.

Case Type	U.S. Case Numbers as of June 30, 2017	Change in Number of Cases Since March 31, 2017 Increase/(Decrease)
Individual Smoking and Health Cases	104	(33)
*West Virginia IPIC (Number of Plaintiffs)**	1 (approx. 564)	No change
Engle Progeny Cases (Number of Plaintiffs)**	2,694 (approx. 3,492)	(83) (78)
Broin II Cases	2,346	(6)
Class-Action Suits	28	1
Filter Cases	73	(5)
Health-Care Cost Recovery Cases	2	No change
State Settlement Agreements-Enforcement and Validity; Adjustments	2	No change
Other Litigation and Developments	22	(2)

* Includes as one case the approximately 564 cases pending as a consolidated action *In Re: Tobacco Litigation Individual Personal Injury Cases*, sometimes referred to as *West Virginia IPIC* cases, described below. The *West Virginia IPIC* cases have been separated from the Individual Smoking and Health cases for reporting purposes.

** The *Engle* Progeny cases have been separated from the Individual Smoking and Health cases for reporting purposes. The number of cases will fluctuate as cases are dismissed or if any of the dismissed cases are appealed.

The Florida state court class-action case, *Engle v. R. J. Reynolds Tobacco Co.*, and the related cases commonly referred to as *Engle* Progeny cases have attracted significant attention. After the Florida Supreme Court's 2006 ruling that members of the formerly certified class could file individual actions, roughly 10,000 claims or actions were filed in Florida state or federal courts before the deadline set by the Florida Supreme Court. No new or additional such claims may be filed. As reflected in the table above, 2,694 *Engle* Progeny cases were pending as of June 30, 2017, that included claims asserted on behalf of 3,492 plaintiffs. Following an agreement to settle most *Engle* Progeny cases that remained pending in federal courts in the first quarter of 2015, nearly all *Engle* Progeny cases currently pending are in Florida state courts. Since 2009, there have been over 200 *Engle* Progeny trials in Florida state or federal courts involving RJR Tobacco Company or Lorillard Tobacco. As described more fully immediately below in "— *Scheduled Trials*" and "— *Trial Results*," additional *Engle* Progeny cases involving RJR Tobacco Company are being tried and set for trial on an ongoing basis. Juries in *Engle* Progeny cases have awarded substantial amounts in compensatory and punitive damage awards, many of which currently are at various stages in the appellate process. RJR Tobacco Company and Lorillard Tobacco also have paid substantial amounts in compensatory and punitive damage awards in *Engle* Progeny cases. For a detailed description of these cases, see "— *Engle and Engle Progeny cases*" below.

In November 1998, the major U.S. cigarette manufacturers, including RJR Tobacco Company, B&W and Lorillard Tobacco, entered into the MSA with 46 U.S. states, Washington, D.C. and certain U.S. territories and possessions. These cigarette manufacturers previously settled four other cases, brought on behalf of Mississippi, Florida, Texas and Minnesota, by separate agreements with each state. These State Settlement Agreements:

- settled all health-care cost recovery actions brought by, or on behalf of, the settling jurisdictions;
- released the major U.S. cigarette manufacturers from various additional present and potential future claims;
- imposed future payment obligations in perpetuity on RJR Tobacco Company, B&W, Lorillard Tobacco and other major U.S. cigarette manufacturers; and
- placed significant restrictions on their ability to market and sell cigarettes and smokeless tobacco products.

Payments under the State Settlement Agreements are subject to various adjustments for, among other things, the volume of cigarettes sold, relative market share, operating profit and inflation. See "— *Health-Care Cost Recovery Cases — State Settlement Agreements*" below for a detailed discussion of the State Settlement

Agreements, including RAI's operating subsidiaries' monetary obligations under these agreements. RJR Tobacco Company records the allocation of settlement charges as products are shipped.

Scheduled Trials

Trial schedules are subject to change, and many cases are dismissed before trial. There are 32 cases, exclusive of *Engle* Progeny cases, scheduled for trial as of June 30, 2017 through June 30, 2018, for RJR Tobacco Company, B&W, Lorillard Tobacco or their affiliates and indemnitees: five individual smoking and health cases, 25 Filter Cases, and two other non-smoking and health cases. There are also approximately 117 *Engle* Progeny cases against RJR Tobacco Company, B&W and/or Lorillard Tobacco set for trial through June 30, 2018. It is not known how many of these cases will actually be tried.

Trial Results

From January 1, 2014 through June 30, 2017, 141 individual smoking and health, *Engle* Progeny, Filter and health-care cost recovery cases in which RJR Tobacco Company, B&W and/or Lorillard Tobacco were defendants were tried, including ten trials for cases where mistrials were declared in the original proceedings. Verdicts in favor of RJR Tobacco Company, B&W and Lorillard Tobacco and, in some cases, other defendants, were returned in 67 cases, tried in Florida (41), California (1) and New Jersey (1). There were also 24 mistrials in Florida. Verdicts in favor of the plaintiffs were returned in 65 cases tried in Florida, and one in California. Six cases in Florida were dismissed during trial. One case in Florida was a retrial only as to the amount of damages. In another case in Florida, the jury entered a partial verdict that did not include compensatory or punitive damages, and post-trial motions are pending.

In the first six months of 2017, 15 *Engle* Progeny cases in which RJR Tobacco Company and/or Lorillard Tobacco was a defendant were tried:

- In *Durrance v. R. J. Reynolds Tobacco Co.*, the jury returned a verdict in favor of RJR Tobacco Company.
- In *John Brown v. Philip Morris USA Inc.*, the jury returned a verdict in favor of the plaintiff; found the decedent 30% at fault, RJR Tobacco Company 35% at fault, and the remaining defendant 35% at fault; and awarded $5.4 million in compensatory damages and $200,000 in punitive damages against each defendant.
- In *Nixon v. R. J. Reynolds Tobacco Co.*, the court declared a mistrial due to the inability to seat a jury.
- In *Fox v. R. J. Reynolds Tobacco Co.*, the jury returned a verdict in favor of the plaintiff, found the decedent 50% at fault and RJR Tobacco Company 50% at fault, and awarded $6 million in compensatory damages. Punitive damages were not awarded.
- In *Theis v. R. J. Reynolds Tobacco Co.*, the court declared a mistrial due to the inability to seat a jury.
- In *Whitmire v. R. J. Reynolds Tobacco Co.*, the jury returned a verdict in favor of the plaintiff, found the decedent 33% at fault and RJR Tobacco Company 67% at fault, and awarded $3 million in compensatory damages. The court declared a mistrial in the second phase of the trial relating to the amount of punitive damages after the jury deadlocked.
- In *Santoro v. R. J. Reynolds Tobacco Co.*, the jury returned a verdict in favor of the plaintiff, found the decedent 36% at fault, RJR Tobacco Company 26% at fault, and the remaining defendants 38% at fault; and awarded approximately $1.6 million in compensatory damages and $90,000 in punitive damages against RJR Tobacco Company and $115,000 in punitive damages against the remaining defendants.
- In *Schlefstein v. R. J. Reynolds Tobacco Co.*, the court declared a mistrial during jury selection.
- In *Lima v. R. J. Reynolds Tobacco Co.*, the jury returned a verdict in favor of the plaintiff; found the decedent 40% at fault, RJR Tobacco Company 60% at fault, and the remaining defendant 0% at fault and awarded $3 million in compensatory damages and $12 million in punitive damages against RJR Tobacco Company.
- In *Shadd v. R. J. Reynolds Tobacco Co.*, the jury returned a verdict in favor of the plaintiff, found the decedent 95% at fault and RJR Tobacco Company 5% at fault, and awarded $0 million in compensatory damages. Punitive damages were not awarded.
- In *Lawrence v. R. J. Reynolds Tobacco Co.*, the jury returned a verdict in favor of the plaintiff, found the decedent 65% at fault and RJR Tobacco Company 35% at fault, awarded approximately $858,200 in compensatory damages, and found that the plaintiff was entitled to punitive damages. Prior to the punitive damages phase, the parties resolved the matter.

- In *Sheffield v. R. J. Reynolds Tobacco Co.*, the jury returned a verdict in favor of the plaintiff, found the decedent 40% at fault, RJR Tobacco Company 60% at fault, awarded $1.8 million in compensatory damages and $5 million in punitive damages.
- In *Olson v. R. J. Reynolds Tobacco Co.*, the court granted RJR Tobacco Company's motion for a mistrial.
- In *Kogan v. R. J. Reynolds Tobacco Co*., the jury returned a verdict in favor of RJR Tobacco Company and the remaining defendant.
- In *Gay v. R. J. Reynolds Tobacco Co.*, a mistrial was granted due to comments made by a prospective juror during jury selection.

In addition, since the end of the second quarter of 2017, two other *Engle* Progeny cases, in which RJR Tobacco Company, B&W and/or Lorillard were a defendant were tried:

- In *Maloney v. R. J. Reynolds Tobacco Co.*, the jury returned a verdict in favor of the plaintiff, found the decedent 50% at fault and RJR Tobacco Company 50% at fault, and awarded $1.65 million in compensatory damages. Punitive damages were not awarded.
- In *Thomas v. R. J. Reynolds Tobacco Co.*, the jury returned a verdict in favor of the plaintiff, found the decedent 45% at fault and RJR Tobacco Company 55% at fault, and awarded $4 million in compensatory damages. Punitive damages were not awarded.

In the first six months of 2017, no non-*Engle* Progeny individual smoking and health cases, in which RJR Tobacco Company, B&W and/or Lorillard Tobacco was a defendant, were tried.

In the first six months of 2017, no Filter cases, in which RJR Tobacco Company and/or Lorillard Tobacco was a defendant, were tried.

For information on the verdicts in the *Engle* Progeny cases that have been tried and remain pending as of June 30, 2017, in which verdicts have been returned against RJR Tobacco Company, Lorillard Tobacco or B&W, or all three, see the *Engle* Progeny cases charts at "— *Engle and Engle Progeny Cases*" below. The following chart reflects the verdicts in the non-*Engle* Progeny smoking and health cases, health-care cost recovery cases or Filter Cases that have been tried and remain pending as of June 30, 2017, in which verdicts have been returned against RJR Tobacco Company, B&W or Lorillard Tobacco, or all three.

Date of Verdict	Case Name/Type	Jurisdiction	Verdict
August 17, 2006	*United States v. Philip Morris USA, Inc.* [Governmental Health-Care Cost Recovery]	U.S. District Court, District of Columbia, (Washington, D.C.)	RJR Tobacco Company, B&W and Lorillard Tobacco were found liable for civil RICO claims; were enjoined from using certain brand descriptors and from making certain misrepresentations; and were ordered to make corrective communications on five subjects, including smoking and health and addiction, to reimburse the U.S. Department of Justice appropriate costs associated with the lawsuit, and to maintain document web sites.
May 26, 2010	*Izzarelli v. R. J. Reynolds Tobacco Co.* [Individual]	U.S. District Court, District of Connecticut, (Bridgeport, CT)	$13.76 million in compensatory damages; 58% of fault assigned to RJR Tobacco Company, which reduced the award to $7.98 million against RJR Tobacco Company; $3.97 million in punitive damages.
September 13, 2013	*DeLisle v. A. W. Chesterton Co.* [Filter]	Circuit Court, Broward County, (Ft. Lauderdale, FL)	$8 million in compensatory damages; 44% of fault assigned to Lorillard Tobacco, which reduced the award to $3.52 million against Lorillard Tobacco.
July 30, 2014	*Major v. Lorillard Tobacco Co.* [Individual]	Superior Court, Los Angeles County, (Los Angeles, CA)	$17.74 million in compensatory damages; 17% of fault assigned to Lorillard Tobacco, which reduced the award to $3.78 million against Lorillard Tobacco.
July 8, 2015	*Larkin v. R. J. Reynolds Tobacco Co.* [Individual]	Circuit Court, Miami-Dade County, (Miami, FL)	$4.96 million in compensatory damages; 62% of fault assigned to RJR Tobacco Company; $8.5 million in punitive damages. Comparative fault did not apply to the final judgment.

For information on the post-trial status of individual smoking and health cases, the governmental health-care cost recovery case and the Filter Cases, see "*— Individual Smoking and Health Cases*," "*— Health-Care Cost Recovery Cases — U.S. Department of Justice Case*," and "*— Filter Cases*," respectively, below.

Individual Smoking and Health Cases

As of June 30, 2017, 104 individual cases were pending in the United States against RJR Tobacco Company, B&W (as RJR Tobacco Company's indemnitee), Lorillard Tobacco or all three. This category of cases includes smoking and health cases alleging personal injuries caused by tobacco use or exposure brought by or on behalf of individual plaintiffs based on theories of negligence, strict liability, breach of express or implied warranty, and violations of state deceptive trade practices or consumer protection statutes. The plaintiffs seek to recover compensatory damages, attorneys' fees and costs, and punitive damages. The category does not include the *Broin II, Engle* Progeny, Filter or *West Virginia IPIC* cases discussed below. One of the individual cases is brought by or on behalf of an individual or his/her survivors alleging personal injury as a result of exposure to environmental tobacco smoke, referred to as ETS.

Below is a description of the non-*Engle* Progeny individual smoking and health cases against RJR Tobacco Company, B&W, and/or Lorillard Tobacco that went to trial or were decided during the period from January 1, 2017 to June 30, 2017, or remained on appeal as of June 30, 2017.

On May 26, 2010, in *Izzarelli v. R. J. Reynolds Tobacco Co*. (U.S.D.C. D. Conn., filed 1999), the jury awarded the plaintiff $13.76 million in compensatory damages on the negligence and strict liability claims, found RJR Tobacco Company 58% at fault and the plaintiff 42% at fault, and found that the plaintiff was entitled to punitive damages. The plaintiff sought to recover damages for personal injuries allegedly sustained as a result of unsafe and unreasonably dangerous cigarette products and for economic losses she sustained as a result of supposed unfair trade practices. On December 5, 2010, the district court (1) awarded the plaintiff $3.97 million in punitive damages based on Connecticut's common-law rule limiting punitive damage awards to the amount of litigation expenses less taxable costs, (2) entered judgment in the amount of $11.95 million (the $13.76 million compensatory damages award reduced by the allocation of fault plus the $3.97 million punitive damages award), and (3) granted the plaintiff $15.8 million in offer of judgment interest through that date and, going forward, approximately $4,000 per day until entry of an amended judgment. In March 2011, the district court entered an amended judgment of approximately $28.1 million. RJR Tobacco Company appealed to the U.S. Court of Appeals for the Second Circuit, referred to as the Second Circuit, and the plaintiff cross appealed. In a non-precedential summary order dated July 7, 2017, the Second Circuit affirmed the $7.98 million compensatory damages award, vacated the $3.97 million punitive damages award, and remanded for a re-determination of punitive damages in light of the Connecticut Supreme Court's decision in the *Bifolck v. Philip Morris, Inc.* case, which ruled that punitive damages in a product liability action are not capped at the amount of litigation expenses less taxable costs under Connecticut's common-law rule, but instead are capped under the Connecticut Product Liability Act at twice the compensatory damages award. RJR Tobacco Company filed a motion for rehearing and rehearing *en banc* on July 21, 2017. A decision is pending.

On July 30, 2014, in *Major v. Lorillard Tobacco Co.* (Super. Ct. Los Angeles County, Cal., filed 2011), the jury awarded the plaintiff approximately $17.74 million in compensatory damages on the negligence and strict liability claims and found the plaintiff 50% at fault, Lorillard Tobacco 17% at fault, and RJR Tobacco Company and another manufacturer collectively 33% at fault. Punitive damages were not at issue. RJR Tobacco Company and the other manufacturer had been dismissed prior to trial. The plaintiffs alleged that as a result of the use of the defendants' products and exposure to asbestos, the decedent, William Major, suffered from lung cancer, and sought an unspecified amount of damages. In August 2014, the trial court entered an initial final judgment of approximately $3.9 million against Lorillard Tobacco. On July 1, 2015, the trial court entered an amended final judgment in the amount of approximately $3.78 million in compensatory damages, approximately $135,000 in costs, approximately $1.9 million in prejudgment interest, and post-judgment interest from August 25, 2014 in the amount of approximately $1,100 per day. Lorillard Tobacco appealed from the original and amended judgments, which appeals have been consolidated, and posted a supersedeas bond in the amount of approximately $9.1 million. On October 20, 2015, the appellate court granted RJR Tobacco Company's motion to substitute itself for Lorillard Tobacco. Oral argument occurred on June 27, 2017. Before oral argument, the court issued a tentative ruling in which it indicated it was inclined to affirm the judgment. A decision is pending.

On July 8, 2015, in *Larkin v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Miami-Dade County, Fla., filed 2002) the jury awarded the plaintiff approximately $4.96 million in compensatory damages on the strict liability and intentional tort claims, found RJR Tobacco Company 62% at fault and the decedent 38% at fault, and awarded $8.5 million in punitive damages. The plaintiff alleged that as a result of using the defendant's products, the decedent suffered from mouth and lung cancer, and sought an unspecified amount of compensatory and punitive

damages. In July 2015, the trial court entered judgment in the amount of approximately $13.46 million. On March 22, 2016, the trial court granted RJR Tobacco Company's motion for a new trial on claims of defective product and damages only and denied the remaining post-trial motions. The new trial has not been scheduled. In April 2016, RJR Tobacco Company appealed to the Third District Court of Appeal, referred to as DCA, and the plaintiff cross appealed. Oral argument occurred on May 3, 2017. On June 28, 2017, the Third DCA affirmed the final judgment and order denying the motion for a new trial as to the fraudulent concealment and conspiracy to conceal claims, reversed the new trial order, and remanded with directions to reinstate the jury verdict. RJR Tobacco Company filed a motion for clarification and motion for rehearing *en banc* or certification to the Florida Supreme Court on July 13, 2017. A decision is pending.

On February 8, 2016, in *Pooshs v. Philip Morris USA, Inc.* (U.S.D.C. N.D. Cal., filed 2004) the jury returned a verdict in favor of the defendants, including RJR Tobacco Company. The plaintiff alleged that as a result of using the defendants' products, the plaintiff suffers from lung cancer. Final judgment was entered on February 9, 2016. The plaintiff filed a notice of appeal to the U.S. Court of Appeals for the Ninth Circuit on March 9, 2016. The case has been stayed through September 20, 2017, pending a decision in *Major*, described above.

West Virginia IPIC

In re: Tobacco Litigation Individual Personal Injury Cases (Cir. Ct. Ohio County, W. Va., filed beginning in 1999), is a series of roughly 1,200 individual cases asserting claims against Philip Morris USA Inc., Lorillard Tobacco, RJR Tobacco Company, B&W and The American Tobacco Company based on alleged personal injuries. The cases were consolidated for a Phase I trial on various defense conduct issues, to be followed in Phase II by individual trials of remaining claims. On May 15, 2013, the Phase I jury found that defendants' cigarettes were not defectively designed; defendants' cigarettes were not defective due to a failure to warn before July 1, 1969; defendants were not negligent, did not breach warranties, and did not engage in conduct warranting punitive damages; and defendants' ventilated filter cigarettes manufactured and sold between 1964 and July 1, 1969 were defective for a failure to instruct. In November 2014, the West Virginia Supreme Court affirmed the verdict. On June 8, 2015, the U.S. Supreme Court denied the plaintiffs' petition for writ of certiorari. On the same date, the trial court issued an order finding that only 30 plaintiffs are alleged to have smoked ventilated filter cigarettes in the relevant period. On October 9, 2015, the trial court outlined the procedures for resolving the claims of the 30 Phase II plaintiffs, which claims will focus on whether plaintiffs blocked cigarette vents and, if so, whether blocking proximately caused their alleged injuries. Five cases were selected to be the first claims tried, and they are tentatively scheduled to be tried beginning in May 2018. In June 2017, the defendants filed a motion to dismiss the failure to instruct claims because the plaintiffs failed to meet the court's deadline to produce experts to support this theory of liability. A decision is pending.

In addition to the foregoing claims, various plaintiffs in 1999 and 2000 asserted claims against retailers and distributors. Those claims were severed and stayed pending the outcome of Phase I. Also, 41 plaintiffs asserted smokeless tobacco claims against various smokeless manufacturers, including 14 claims against certain Reynolds Defendants. Those claims were severed from *IPIC* in 2001, and the plaintiffs took no action to prosecute the claims. They now seek to activate their smokeless claims. On January 25, 2017, the trial court denied the defendants' motion to dismiss those claims as abandoned. The plaintiffs are now free to move forward with their claims.

Engle and Engle Progeny Cases

In July 1998, trial began in *Engle v. R. J. Reynolds Tobacco Co.,* a then-certified class action filed in Circuit Court, Miami-Dade County, Florida, against U.S. cigarette manufacturers, including RJR Tobacco Company, B&W, Lorillard Tobacco, Philip Morris USA Inc., and others. The then-certified class consisted of Florida citizens and residents, and their survivors, who suffered from smoking-related diseases that first manifested between May 5, 1990, and November 21, 1996, and were caused by an addiction to cigarettes. In July 1999, the jury in Phase I found against RJR Tobacco Company, B&W, Lorillard Tobacco and the other defendants on common issues relating to the defendants' conduct, general causation, the addictiveness of cigarettes, and entitlement to punitive damages.

On July 14, 2000, the jury in Phase II awarded the class a total of approximately $145 billion in punitive damages, which were apportioned $36.3 billion to RJR Tobacco Company, $17.6 billion to B&W, and $16.3 billion to Lorillard Tobacco. The defendants appealed.

On December 21, 2006, the Florida Supreme Court prospectively decertified the class and set aside the jury's Phase II punitive damages award. But the court preserved certain of the jury's Phase I findings, including that cigarettes can cause certain diseases, nicotine is addictive, and defendants placed defective cigarettes on the

market, breached duties of care, concealed health-related information, and conspired. The court also authorized former class members to file individual lawsuits within one year, and it stated that the preserved findings would have *res judicata* effect in those actions.

In the year after the Florida Supreme Court's *Engle* decision, putative class members filed thousands of individual actions against RJR Tobacco Company, B&W, Lorillard Tobacco, Philip Morris USA Inc., and the other *Engle* defendants, which actions commonly are referred to as *Engle* Progeny cases. As of June 30, 2017, 2,682 *Engle* Progeny cases were pending in state courts, and 12 *Engle* Progeny cases were pending in federal court against RJR Tobacco Company, B&W and/or Lorillard Tobacco. Those cases include claims by or on behalf of approximately 3,492 plaintiffs. As of June 30, 2017, RJR Tobacco Company also was aware of nine additional *Engle* Progeny cases that have been filed but not served. The number of pending cases fluctuates for a variety of reasons, including voluntary and involuntary dismissals. Voluntary dismissals include cases in which a plaintiff accepts an "offer of judgment," referred to in Florida statutes as "proposals for settlement," from RJR Tobacco Company, Lorillard Tobacco and/or RJR Tobacco Company's affiliates and indemnitees. An offer of judgment, if rejected by the plaintiff, preserves RJR Tobacco Company's and Lorillard Tobacco's right to recover attorneys' fees under Florida law in the event of a verdict favorable to RJR Tobacco Company or Lorillard Tobacco. Such offers are sometimes made through court-ordered mediations.

At the beginning of the *Engle* Progeny litigation, a central issue was the proper use of the preserved *Engle* findings. RJR Tobacco Company has argued that use of the *Engle* findings to establish individual elements of Progeny claims (such as defect, negligence and concealment) is a violation of federal due process. In 2013, however, both the Florida Supreme Court and the U.S. Court of Appeals for the Eleventh Circuit, referred to as the Eleventh Circuit, rejected that argument. As noted below, the Eleventh Circuit, this time sitting *en banc*, recently heard argument on this issue again. In addition to this global due process argument, RJR Tobacco Company and Lorillard Tobacco raise many other factual and legal defenses as appropriate in each case. These defenses may include, among other things, arguing that the plaintiff is not a proper member of the *Engle* class, that the plaintiff did not rely on any statements by any tobacco company, that the trial was conducted unfairly, that some or all claims are preempted or barred by applicable statutes of limitation, or that any injury was caused by the smoker's own conduct. In *Hess v. Philip Morris USA Inc.* and *Russo v. Philip Morris USA Inc.*, decided on April 2, 2015, the Florida Supreme Court held that, in *Engle* Progeny cases, the defendants cannot raise a statute of repose defense to claims for concealment or conspiracy. On April 8, 2015, in *Graham v. R. J. Reynolds Tobacco Co.*, the Eleventh Circuit held that federal law impliedly preempts use of the preserved *Engle* findings to establish claims for strict liability or negligence. On January 21, 2016, the Eleventh Circuit granted the plaintiff's motion for rehearing *en banc* and vacated the panel decision. On May 18, 2017, the *en banc* Eleventh Circuit rejected RJR Tobacco Company's due process and implied preemption arguments. On January 6, 2016, in *Marotta v. R. J. Reynolds Tobacco Co.*, the Fourth DCA disagreed with the *Graham* panel decision and held that federal law does not impliedly preempt any tort claims against cigarette manufacturers, including those of *Engle* Progeny plaintiffs. The Florida Supreme Court accepted jurisdiction in *Marotta,* heard oral argument, and on April 6, 2017, found that federal law does not preempt the *Engle* Progeny plaintiff's claims and remanded for further proceedings on punitive damages.

In June 2009, Florida amended its existing bond cap statute by adding a $200 million bond cap that applied to all *Engle* Progeny cases in the aggregate. In May 2011, Florida removed the provision that would have allowed the bond cap to expire on December 31, 2012. The bond cap for any given individual *Engle* Progeny case varies depending on the number of judgments on appeal at a given time, but never exceeds $5 million per case for appeals within the Florida state court system. The legislation, which became effective in June 2009 and 2011, applied to judgments entered after the original 2009 effective date.

During 2015, RJR Tobacco Company and Lorillard Tobacco, together with Philip Morris USA Inc., settled virtually all of the *Engle* Progeny cases then pending against them in federal district court. The total amount of the settlement was $100 million divided as follows: RJR Tobacco Company — $42.5 million; Philip Morris USA Inc. — $42.5 million; and Lorillard Tobacco — $15 million. The settlement covered more than 400 federal Progeny cases but did not cover 12 federal Progeny cases previously tried to verdict and currently pending on post-trial motions or appeal; and 2 federal Progeny cases filed by different lawyers from the ones who negotiated the settlement for the plaintiffs. Between August 3, 2015 and January 4, 2016, RJR Tobacco Company and Philip Morris USA Inc. removed 39 *Engle* Progeny cases from state to federal courts in Florida. These cases were not part of the settlement described above and were all remanded back to state court.

One hundred thirty-seven *Engle* Progeny cases have been tried in Florida state and federal courts since the beginning of 2014 through June 30, 2017, and additional state court trials are scheduled for 2017 and 2018. Since the beginning of 2014 through June 30, 2017, RJR Tobacco Company or Lorillard Tobacco has paid judgments in 39 *Engle* Progeny cases. Those payments totaled $344.1 million and included $246.3 million for compensatory

or punitive damages and $97.8 million for attorneys' fees and statutory interest. In addition, accruals for damages and attorneys' fees and statutory interest for *Starr-Blundell, Monroe Lourie, Lewis and Block* and an accrual for attorneys' fees and interest for *Ward* were recorded in RAI's unaudited condensed consolidated balance sheet as of June 30, 2017, included in this Offering Memorandum. The following chart reflects the details of accrued compensatory damages related to *Starr-Blundell, Monroe, Lourie, Lewis and Block.*

Plaintiff Case Name	RJR Tobacco Company Allocation of Fault	Lorillard Tobacco Allocation of Fault	Compensatory Damages (as adjusted)[1]	Punitive Damages	Appeal Status
Starr-Blundell . .	10%	—	$ 50,000	$ —	First DCA, *per curiam*, reversed and remanded its May 29, 2015 opinion to the trial court for reconsideration in light of the decision in *Soffer;* retrial limited to punitive damages on the plaintiff's non-intentional tort claims is scheduled for February 2018
Monroe	58%	—	6,380,000	—	First DCA affirmed the final judgment, *per curiam*, on March 23, 2017; Florida Supreme Court declined to accept jurisdiction on June 13, 2017; deadline to file petition for writ of certiorari with the U.S. Supreme Court is September 11, 2017
Lourie	3%	7%	137,000	—	Second DCA affirmed the final judgment; Florida Supreme Court declined to accept jurisdiction based on their decision in *Marotta*; deadline to file a petition for writ of certiorari with the U.S. Supreme Court is September 18, 2017
Lewis	25%	—	187,500	—	Fifth DCA affirmed the final judgment, *per curiam*, on May 2, 2017; deadline to file a petition for writ of certiorari with the U.S. Supreme Court is September 29, 2017
Block	50%	—	463,000	800,000	Fourth DCA affirmed the final judgment, *per curiam*, on April 27, 2017; deadline to file a petition for writ of certiorari with the U.S. Supreme Court is September 22, 2017
Totals			$7,217,500	$800,000	

(1) Compensatory damages are adjusted to reflect the reduction that may be required by the allocation of fault. Punitive damages are not adjusted and reflect the amount of the final judgment(s) signed by the trial court judge(s). The amount listed above does not include attorneys' fees or statutory interest of approximately $3.6 million in *Starr-Blundell*, *Monroe*, *Lourie*, *Lewis* and *Block* or approximately $1.6 million in attorneys' fees and statutory interest in *Ward*.

The following chart lists judgments in all other individual *Engle* Progeny cases pending as of June 30, 2017, in which a verdict or judgment has been returned against RJR Tobacco Company, B&W, and/or Lorillard Tobacco and the verdict or judgment has not been set aside on appeal. No liability for any of these cases has been recorded in RAI's unaudited condensed consolidated balance sheet as of June 30, 2017, included in this Offering Memorandum. This chart does not include the mistrials or verdicts returned in favor of RJR Tobacco Company, B&W, and/or Lorillard Tobacco.

Plaintiff Case Name	**RJR Tobacco Company Allocation of Fault**	**Lorillard Tobacco Allocation of Fault**	**Compensatory Damages (as adjusted)[1]**	**Punitive Damages**	**Appeal Status**
Putney	30%	—	$ —	$ 2,500,000	Fourth DCA reinstated the punitive damages awards of $2.5 million each against RJR Tobacco Company and the remaining defendant; court's opinion that previously granted remittitur of the compensatory damages awards still stands; remanded to trial court for further proceedings
Andy Allen	24%	—	2,475,000	7,756,000	First DCA affirmed the judgment of the trial court; First DCA granted defendants motion for rehearing *en banc* on June 15, 2017, and ordered further briefing
Calloway	27%	18%	—	—	Fourth DCA granted rehearing *en banc* and substituted a new opinion ordering a new trial based on improper argument; plaintiff filed a petition for writ of certiorari with the U.S. Supreme Court on June 14, 2017; a new trial date has not been scheduled
James Smith	55%	—	600,000[2]	20,000	Pending — Eleventh Circuit
Evers	60%	9%	2,950,000	12,360,000	Second DCA reinstated punitive damage award of $12.36 million the trial court had set aside; the verdict was reinstated on remand; a subsequent appeal is pending in the Second DCA; oral argument occurred on February 7, 2017; decision is pending
Schoeff	75%	—	7,875,000	—	Pending — Florida Supreme Court
Marotta	58%	—	3,480,000	—	Florida Supreme Court found that federal law does not preempt the plaintiff's claims; remanded for further proceedings regarding punitive damages; trial has been scheduled for the July 4, 2018 through September 28, 2018 trial calendar.
Searcy	30%	—	500,000[2]	1,670,000	Pending — Eleventh Circuit
Earl Graham . . .	20%	—	550,000	—	Eleventh Circuit, sitting *en banc*, rejected the defendants' due process and implied preemption claims with dissents; deadline to file a petition for writ of certiorari with the U.S. Supreme Court is September 15, 2017.
Grossman	75%	—	11,514,000	22,500,000	Fourth DCA ordered award of compensatory damages reduced to reflect comparative fault, but otherwise affirmed; RJR Tobacco Company's motion for rehearing was denied on March 16, 2017; plaintiff and RJR Tobacco Company filed notices to invoke the discretionary jurisdiction of the Florida Supreme Court; decision is pending
Burkhart	25%	10%	3,500,000[2]	1,750,000	Pending — Eleventh Circuit

Plaintiff Case Name	RJR Tobacco Company Allocation of Fault	Lorillard Tobacco Allocation of Fault	Compensatory Damages (as adjusted)[1]	Punitive Damages	Appeal Status
Bakst (Odom) . . .	75%	—	—	—	Fourth DCA reversed the judgment of the trial court and remanded the case for a new trial on damages only; motion for rehearing was denied on February 27, 2017; the plaintiff filed a notice to invoke the discretionary jurisdiction of the Florida Supreme Court on March 27, 2017; decision is pending
Robinson	71%	—	—	—	First DCA reversed judgment and remanded case for a new trial and denied rehearing; new trial has not been scheduled; on June 14, 2017, the plaintiff filed a notice to invoke the discretionary jurisdiction of the Florida Supreme Court: decision is pending
Harris	15%	10%	1,100,000[2]	—	Post-trial motions are pending[3]
Irimi	14.5%	14.5%	—	—	Pending — Fourth DCA
Kerrivan	31%	—	6,046,660[2]	9,600,000	Post-trial motions are pending[3]
Schleider	70%	—	14,700,000	—	Pending — Third DCA
Perrotto	20%	6%	1,063,000	—	Plaintiff’s motion for a new trial granted as to punitive damages; new trial scheduled for December 1, 2017
Ellen Gray	50%	—	3,000,000	—	Post-trial motions are pending[3]
Sowers	50%	—	2,125,000	—	Post-trial motions are pending[3]
Caprio	20%	10%	167,700	—	New trial scheduled for August 9, 2017
Zamboni	30%	—	102,000	—	Final judgment has not been entered
Pollari	42.5%	—	4,250,000	1,500,000	Pending — Fourth DCA
Gore	23%	—	460,000	—	Pending — Fourth DCA
Ryan	65%	—	13,975,000	25,000,000	Pending — Fourth DCA
Hardin	13%	—	100,880	—	Third DCA remanded the case for a new trial on punitive damages for the non — intentional tort claims; new trial is scheduled to begin August 21, 2017.
McCoy	25%	20%	670,000	6,000,000	Pending — Fourth DCA
Cooper	40%	—	1,200,000	—	Pending — Fourth DCA
Duignan	30%	—	2,690,000[2]	2,500,000	Pending — Second DCA
O’Hara	85%	—	14,700,000	20,000,000	Pending — First DCA
Marchese	22.5%	—	225,000	250,000	Pending — Fourth DCA
Barbose	42.5%	—	5,000,000[2]	500,000	Pending — Second DCA
Ledoux	47%	—	5,000,000[2]	12,500,000	Pending — Third DCA
Ewing	2%	—	4,800	—	Post-trial motions denied; final judgment has not been entered
Ahrens	44%	—	5,800,000[2]	2,500,000	Second DCA affirmed the final judgment, *per curiam*; defendants’ motion for a written opinion granted; new opinion substituted; deadline for the defendants to file a notice to invoke the discretionary jurisdiction of the Florida Supreme Court is August 11, 2017
Turner	80%	—	2,400,000	10,000,000	Pending — Fourth DCA
Enochs	66%	—	13,860,000	6,250,000	Pending — Fourth DCA
Dion	75%	—	12,000,000[2]	30,000	Pending — Second DCA
Nally	75%	—	6,000,000[2]	12,000,000	Pending — Second DCA
McCabe	30%	—	1,500,000	6,500,000	Pending — Second DCA
Sermons	5%	—	3,250	17,075	Post-trial motions are pending[3]
Mathis	55%	—	5,000,000[2]	—	Pending — Third DCA
Oshinsky-Blacker	25%	—	—	—	Pending — Fourth DCA
Sherry Smith . . .	65%	—	3,000,000[2]	—	Pending — Fifth DCA
Prentice	40%	—	2,560,000	—	Pending — First DCA

Plaintiff Case Name	RJR Tobacco Company Allocation of Fault	Lorillard Tobacco Allocation of Fault	Compensatory Damages (as adjusted)[1]	Punitive Damages	Appeal Status
Konzelman	85%	—	7,476,000	20,000,000	Pending — Fourth DCA
Ledo	49%	—	2,940,000[2]	—	Post-trial motions are pending[3]
Johnston	90%	—	6,750,000	14,000,000	Pending — Second DCA
Howles	50%	—	2,000,000	3,000,000	Pending — Fourth DCA
Ford	15%	—	153,400	—	Pending — Fourth DCA
Martin	22%	—	1,190,400	200,000	Pending — Fourth DCA
Pardue	50%	—	3,467,000[2]	6,750,000	Pending — First DCA
John Brown	35%	—	2,700,000[2]	200,000	Post-trial motions are pending[3]
Fox	50%	—	3,000,000	—	Post-trial motions denied; RJR Tobacco Company filed a notice of appeal to the Fourth DCA on July 24, 2017
Whitmire	67%	—	3,000,000	—	Pending — First DCA
Santoro	26%	—	417,000	90,000	Post-trial motions are pending[3]
Lima	60%	—	1,800,000	12,000,000	Post-trial motions are pending[3]
Sheffield	60%	—	1,800,000[2]	5,000,000	Post-trial motions denied and final judgment entered against RJR Tobacco in the amount of $1.8 million in compensatory damages and $5 million in punitive damages; deadline for RJR Tobacco to file a notice of appeal to the Fifth DCA is August 9, 2017
Maloney	50%	—	1,650,000[2]	—	Post-trial motions are pending[3]
Thomas	55%	—	2,200,000	—	Post-trial motions are pending[3]
Totals			$202,691,090	$224,943,075	

(1) Unless otherwise noted, compensatory damages in these cases are adjusted to reflect the jury's allocation of comparative fault. Punitive damages are not so adjusted. The amounts listed above do not include attorneys' fees or statutory interest that may apply to the judgments and such fees and interest may be material.

(2) The court did not apply comparative fault in the final judgment.

(3) Should the pending post-trial motions be denied, RJR Tobacco Company will likely file a notice of appeal with the appropriate appellate court.

As reflected in the preceding chart, as of June 30, 2017, verdicts or judgments in favor of *Engle* Progeny plaintiffs have been entered and remain outstanding against RJR Tobacco Company or Lorillard Tobacco totaling $202,691,090 in compensatory damages (as adjusted) and $224,943,075 in punitive damages, which is a combined total of $427,634,165. These verdicts or judgments are at various stages in the post-trial or appellate process. RJR Tobacco Company believes that RJR Tobacco Company and Lorillard Tobacco have valid defenses in these cases, including case-specific issues beyond the due process issue discussed above, and, as described in more detail above in "*— Accounting for Tobacco-Related Litigation Contingencies*," RJR Tobacco Company and its affiliates vigorously defend smoking and health claims, including *Engle* Progeny cases.

Should RJR Tobacco Company or Lorillard Tobacco not prevail in any particular individual *Engle* Progeny case or determine that in any individual *Engle* Progeny case an unfavorable outcome has become probable and the amount can be reasonably estimated, a loss would be recognized, which could have a material adverse effect on the results of operations, cash flows and financial position of RAI. This position on loss recognition for *Engle* Progeny cases as of June 30, 2017, is consistent with RAI's and RJR Tobacco Company's historical position on loss recognition for other smoking and health litigation. It is the policy of RJR Tobacco Company to record any loss concerning litigation at such time as an unfavorable outcome becomes probable and the amount can be reasonably estimated on an individual case-by-case basis.

Below is a description of the *Engle* Progeny cases against RJR Tobacco Company, B&W, and/or Lorillard Tobacco that went to trial or were decided during the period from January 1, 2017 to June 30, 2017, or remained on appeal as of June 30, 2017, listed chronologically by the date of the verdict. In each case, the plaintiff: (1) alleged that the smoker was addicted to nicotine in cigarettes and, as a result of that addiction, suffered or died from one or more smoking-related diseases; (2) asserted claims based on theories of negligence, strict liability, and intentional tort; and (3) sought to recover unspecified compensatory damages, as well as attorneys' fees and costs. The plaintiffs in most, but not all, cases also sought to recover punitive damages.

On April 13, 2010, in *Putney v. R. J. Reynolds Tobacco Co*. (Cir. Ct. Broward County, Fla., filed 2007), a jury in Phase I of the trial returned a verdict for the plaintiff. On April 26, 2010, the jury in Phase II of the trial found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $15.1 million in compensatory damages; found the decedent 35% at fault, RJR Tobacco Company 30% at fault and the remaining defendants collectively 35% at fault; and awarded $2.5 million in punitive damages against each of RJR Tobacco Company and one of the remaining defendants. In August 2010, the trial court entered final judgment against RJR Tobacco Company in the amount of $4.5 million in compensatory damages and $2.5 million in punitive damages. In December 2010, the trial court entered an amended final judgment to provide that interest would run from April 26, 2010. In June 2013, the Fourth DCA held that the trial court erred in denying the defendants' motion for remittitur of the compensatory damages for loss of consortium and in striking the defendants' statute of repose affirmative defenses. As a result, the Fourth DCA reversed and remanded for further proceedings. After its April 2, 2015, ruling in *Hess v. Philip Morris USA Inc.* that *Engle* Progeny defendants cannot raise a statute of repose defense to claims for concealment or conspiracy, the Florida Supreme Court, on February 1, 2016, accepted jurisdiction in *Putney*, quashed the Fourth DCA's decision and reinstated the verdict. On March 15, 2016, the Florida Supreme Court granted the defendants' motion for clarification in an order stating that remand was for reconsideration only on the issue of the statute of repose. On August 31, 2016, the Fourth DCA entered a new opinion following remand from the Florida Supreme Court. The court reinstated the punitive damages awards of $2.5 million each against RJR Tobacco Company and the remaining defendant. The court's opinion that previously granted remittitur of the compensatory damages awards still stands. The matter has been remanded to the trial court for further proceedings.

On April 21, 2010, in *Grossman v. R. J. Reynolds Tobacco Co*. (Cir. Ct. Broward County, Fla., filed 2007), the jury, in Phase I of a retrial that followed a mistrial, returned a verdict for the plaintiff. On April 29, 2010, the jury in Phase II of the retrial found for the plaintiff on the strict liability claim and for RJR Tobacco Company on the negligence, warranty, and intentional tort claims; awarded $1.9 million in compensatory damages; found RJR Tobacco Company 25% at fault, the decedent 70% at fault, and the decedent's spouse 5% at fault; and did not reach the issue of entitlement to punitive damages. In June 2010, the trial court entered final judgment against RJR Tobacco Company in the amount of approximately $484,000 in compensatory damages. In June 2012, the Fourth DCA affirmed the trial court's judgment, but remanded for a new trial on all Phase II issues. On July 31, 2013, the jury in the second retrial found for the plaintiff on the intentional tort claims, awarded $15.35 million in compensatory damages, found the decedent 25% at fault and RJR Tobacco Company 75% at fault, and awarded $22.5 million in punitive damages. The trial court entered final judgment in August 2013 and did not include a reduction for comparative fault. RJR Tobacco Company appealed, and the plaintiff cross appealed. On January 4, 2017, the Fourth DCA ordered the award of compensatory damages be reduced to reflect the comparative fault allocation assigned by the jury, but otherwise affirmed the final judgment. RJR Tobacco Company's motion for rehearing was denied on March 16, 2017. The plaintiff filed a notice to invoke the discretionary jurisdiction of the Florida Supreme Court on April 13, 2017. RJR Tobacco Company filed a notice to invoke the discretionary jurisdiction of the Florida Supreme Court on April 14, 2017. In orders dated April 19, 2017, and April 21, 2017, the Florida Supreme Court stayed those matters pending the resolution of *Schoeff*, described below. On May 11, 2017, the Florida Supreme Court lifted the stay as to RJR Tobacco Company's notice to invoke the court's jurisdiction. Jurisdictional briefing is complete, and a decision is pending.

On May 20, 2010, in *Buonomo v. R. J. Reynolds Tobacco Co*. (Cir. Ct. Broward County, Fla., filed 2007), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $5.2 million in compensatory damages; found RJR Tobacco Company 77.5% at fault and the decedent 22.5% at fault; and awarded $25 million in punitive damages. In accordance with a Florida statute, the trial court later reduced the punitive damage award to $15.7 million — three times the compensatory damages award of $5.2 million and entered final judgment in the amount of $4.06 million in compensatory damages and $15.7 million in punitive damages. In September 2013, the Fourth DCA affirmed the judgment and damages award to the plaintiff on strict liability and negligence, held that the trial court was not bound to hold punitive damages at three times compensatory damages, and reversed the judgment entered for the plaintiff on the claims for fraudulent concealment and conspiracy to commit fraud by concealment due to the erroneous striking of RJR Tobacco Company's statute of repose defense. As a result, the punitive damages award was set aside and remanded for a new trial. In October 2014, the trial court found that the original $25 million punitive damages award was not excessive and would be reinstated if the plaintiff prevails on the repose issue and, in April 2015, entered an amended judgment against RJR Tobacco Company in the amount of approximately $29.1 million from which RJR Tobacco Company appealed. After its April 2, 2015, ruling in *Hess v. Philip Morris USA Inc.* that *Engle* Progeny defendants cannot raise a statute of repose defense to claims for concealment or conspiracy, the Florida Supreme Court, on January 26, 2016, accepted jurisdiction in *Buonomo*, quashed the Fourth DCA's decision, and reinstated the jury verdict. RJR Tobacco Company's motion for clarification was denied on March 21, 2016. In the appeal of the amended final judgment, on September 22, 2016, the Fourth DCA affirmed the amended final

judgment, *per curiam*. RJR Tobacco Company's motion for rehearing was denied in October 2016. After further evaluation of the case, RJR Tobacco Company paid approximately $42.8 million in satisfaction of the judgment on March 28, 2017.

On April 26, 2011, in *Andy Allen v. R. J. Reynolds Tobacco Co*. (Cir. Ct. Duval County, Fla., filed 2007), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $6 million in compensatory damages; found RJR Tobacco Company 45% at fault, the decedent 40% at fault, and the remaining defendant 15% at fault; and awarded $17 million in punitive damages against each defendant. The trial court entered final judgment against RJR Tobacco Company in the amount of $19.7 million in May 2011 and, in October 2011, entered a remittitur of the punitive damages to $8.1 million. In May 2013, the First DCA reversed and remanded the case for a new trial. On November 24, 2014, the jury in the retrial found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $3.1 million in compensatory damages; found the decedent 70% at fault, RJR Tobacco Company 24% at fault, and the remaining defendant to be 6% at fault; and found that the plaintiff was entitled to punitive damages. On November 26, 2014, the jury awarded approximately $7.75 million in punitive damages against each defendant. In August 2015, the trial court entered final judgment against RJR Tobacco Company and the remaining defendant, jointly and severally, in the amount of approximately $3.1 million in compensatory damages and $7.75 million in punitive damages from each defendant. In September 2015, the defendants filed a notice of appeal to the First DCA. On February 24, 2017, the First DCA affirmed the judgment of the trial court. The court granted the defendants' motion for rehearing *en banc* on June 15, 2017. Supplemental briefing is underway.

On May 17, 2012, in *Calloway v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Broward County, Fla., filed 2007), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $20.5 million in compensatory damages; found the decedent 20.5% at fault, RJR Tobacco Company 27% at fault, Lorillard Tobacco 18% at fault, and the remaining defendants collectively 34.5% at fault; and found that the plaintiff was entitled to punitive damages. On May 31, 2012, the jury awarded punitive damages in the amount of $17.25 million against RJR Tobacco Company, $12.6 million against Lorillard Tobacco, and $25 million collectively against the remaining defendants. The trial court later determined that the jury's apportionment of comparative fault did not apply to the compensatory damages award and, in August 2012, entered final judgment. On January 6, 2016, the Fourth DCA reversed the fraudulent concealment and conspiracy claims, reversed the punitive damages award, and remanded the case for a new trial on those issues. On September 23, 2016, the Fourth DCA, sitting *en banc,* reversed the judgment in its entirety and remanded the case for a new trial. On March 16, 2017, the Florida Supreme Court declined to accept jurisdiction of the case. The new trial has not been scheduled. On June 14, 2017, the plaintiff filed a petition for writ of certiorari with the U.S. Supreme Court. A decision is pending.

On October 17, 2012, in *James Smith v. R. J. Reynolds Tobacco Co*. (U.S.D.C. M.D. Fla., filed 2007), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $600,000 in compensatory damages; found the decedent 45% at fault and RJR Tobacco Company 55% at fault; and found that the plaintiff was entitled to punitive damages. On October 18, 2012, the jury awarded $20,000 in punitive damages. The trial court entered final judgment against RJR Tobacco Company in the amount of $620,000. RJR Tobacco Company appealed to the Eleventh Circuit and posted a supersedeas bond in the amount of approximately $620,000. Oral argument occurred on October 17, 2014. A decision is pending.

On February 11, 2013, in *Evers v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Hillsborough County, Fla., filed 2007), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $3.23 million in compensatory damages; found the decedent 31% at fault, RJR Tobacco Company 60% at fault and Lorillard Tobacco 9% at fault; and found that the plaintiff was entitled to punitive damages from RJR Tobacco Company but not from Lorillard Tobacco. On February 12, 2013, the jury awarded $12.36 million in punitive damages against RJR Tobacco Company. In March 2013, the trial court granted the defendants' post-trial motions for directed verdict on fraudulent concealment, conspiracy and punitive damages and set aside the $12.36 million punitive damages award. The trial court entered final judgment in the amount of $1.77 million against RJR Tobacco Company and approximately $266,000 against Lorillard Tobacco. On November 6, 2015, the Second DCA concluded that the trial court erred in granting the defendants' motion for directed verdict on claims for fraud by concealment and conspiracy to commit fraud by concealment, and reversed and reinstated the jury's verdict on those two claims. As a result, the punitive damages award was reinstated. On remand, the jury's verdict was reinstated. On March 14, 2016, the trial court entered an amended final judgment against RJR Tobacco Company in the amount of $2.95 million in compensatory damages and $12.36 million in punitive damages. In April 2016, RJR Tobacco Company appealed to the Second DCA and posted a supersedeas bond in the amount of $5 million. Oral argument occurred on February 7, 2017. A decision is pending.

On February 13, 2013, in *Schoeff v. R. J. Reynolds Tobacco Co*. (Cir. Ct. Broward County, Fla., filed 2007), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $10.5 million

in compensatory damages; found the decedent 25% at fault and RJR Tobacco Company 75% at fault; and found that the plaintiff was entitled to punitive damages. On February 14, 2013, the jury awarded $30 million in punitive damages. In April 2013, the trial court entered final judgment against RJR Tobacco Company in the amount of $7.88 million in compensatory damages and $30 million in punitive damages. On November 4, 2015, the Fourth DCA reversed the punitive damages portion of the final judgment and remanded the case to the trial court, directing the trial court to grant RJR Tobacco Company's motion for remittitur and, if RJR Tobacco Company does not agree with the remitted amount, to hold a new trial on punitive damages. On May 26, 2016, the Florida Supreme Court accepted jurisdiction of the case. Oral argument occurred on March 8, 2017. A decision is pending.

On March 20, 2013, in *Marotta v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Broward County, Fla., filed 2007), the jury, in a retrial following a mistrial, found for the plaintiff on the strict liability claim and for RJR Tobacco Company on the negligence and intentional tort claims, awarded $6 million in compensatory damages, found the decedent 42% at fault and RJR Tobacco Company 58% at fault, and did not reach the issue of entitlement to punitive damages. The trial court later entered final judgment against RJR Tobacco Company in the amount of $3.48 million. On January 6, 2016, the Fourth DCA affirmed, disagreeing with the Eleventh Circuit panel decision in *Graham*, discussed below, regarding whether federal law preempts the plaintiff's claims. The Fourth DCA also certified a question presenting the preemption issue to the Florida Supreme Court. On March 8, 2016, the Florida Supreme Court accepted jurisdiction of the case. On April 6, 2017, the Florida Supreme Court rephrased the certified question and then found that federal law does not preempt the plaintiff's claims. The Florida Supreme Court then remanded the case to the Fourth DCA for further proceedings regarding punitive damages in light of its decision in *Soffer*. On May 2, 2017, the Fourth DCA remanded the case to the trial court for a trial on punitive damages. The trial has been scheduled for the July 4, 2018 through September 28, 2018 trial calendar.

On April 1, 2013, in *Searcy v. R. J. Reynolds Tobacco Co.* (U.S.D.C. M.D. Fla., filed 2008), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $6 million in compensatory damages; found the decedent 40% at fault, RJR Tobacco Company 30% at fault and the remaining defendant 30% at fault; and awarded $10 million in punitive damages against each defendant. The trial court later entered final judgment against RJR Tobacco Company in the amount of $6 million in compensatory damages and $10 million in punitive damages. In September 2013, the trial court granted the defendants' motion for a new trial, or in the alternative, reduction or remittitur of the damages awarded to the extent it sought remittitur of the damages. The compensatory damage award was remitted to $1 million, and the punitive damage award was remitted to $1.67 million against each defendant. The plaintiff filed a notice of acceptance of remittitur in November 2013, and the trial court issued an amended final judgment. The defendants appealed to the Eleventh Circuit, and RJR Tobacco Company posted a supersedeas bond in the amount of approximately $2.2 million. Oral argument occurred on October 17, 2014. The court ordered the parties to file supplemental briefs addressing the impact of *Graham*, described below. Briefs have been submitted, and a decision is pending.

On May 2, 2013, in *David Cohen v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Palm Beach County, Fla., filed 2007), a jury found for the plaintiff on the negligence and strict liability claims and for the defendants on the intentional tort claims; awarded $2.06 million in compensatory damages; found the decedent 40% at fault, RJR Tobacco Company 30% at fault, Lorillard Tobacco 20% at fault and the remaining defendant 10% at fault; and did not reach the issue of entitlement to punitive damages. In May 2013, the trial court entered final judgment against RJR Tobacco Company in the amount of $617,000 and against Lorillard Tobacco in the amount of approximately $411,000. In July 2013, the court granted the defendants' motion for a new trial due to the plaintiff's improper arguments during closing. The new trial date has not been scheduled. The plaintiff filed a notice of appeal to the Fourth DCA, and the defendants filed a notice of cross appeal. On September 7, 2016, the Fourth DCA affirmed the trial court's order granting RJR Tobacco Company's motion for a new trial. The Florida Supreme Court declined to accept jurisdiction of the case on March 16, 2017. The plaintiff did not seek further review.

On May 23, 2013, in *Earl Graham v. R. J. Reynolds Tobacco Co.* (U.S.D.C. M.D. Fla., filed 2008), a jury found for the plaintiff on the negligence and strict liability claims and for the defendants on the intentional tort claims; awarded $2.75 million in compensatory damages; found the decedent 70% at fault, RJR Tobacco Company 20% at fault, and the remaining defendant 10% at fault, and did not reach the issue of entitlement to punitive damages. In May 2013, the trial court entered final judgment against RJR Tobacco Company in the amount of $550,000. On April 8, 2015, the Eleventh Circuit reversed and ordered entry of judgment for RJR Tobacco Company. The Eleventh Circuit held that federal law impliedly preempts claims for strict liability and negligence based on the defect and negligence findings from *Engle*. On January 21, 2016, the plaintiff's motion for rehearing *en banc* was granted, and the panel's decision was vacated. On March 23, 2016, the Eleventh Circuit requested briefing on the issues of whether plaintiff's claims are preempted and, if not, whether the

defendants' due process rights are violated. On May 18, 2017, the Eleventh Circuit issued its *en banc* opinion. The court held that giving preclusive effect to the findings of negligence and strict liability by the *Engle* jury in individual actions by *Engle* class members against the tobacco companies is not preempted by federal tobacco laws and does not deprive the tobacco companies of due process. The judgment against RJR Tobacco Company and the remaining defendant was affirmed. The deadline for the defendants to file a petition for writ of certiorari with the U.S. Supreme Court is September 15, 2017.

On June 4, 2013, in *Starr-Blundell v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Duval County, Fla., filed 2007), a jury found for the plaintiff on the negligence and strict liability claims and for the defendants on the intentional tort claims; awarded $500,000 in compensatory damages; found the decedent 80% at fault, RJR Tobacco Company 10% at fault and the remaining defendant 10% at fault; and did not reach the issue of entitlement to punitive damages. In November 2013, the trial court entered final judgment in the amount of $50,000 against each defendant. On May 29, 2015, the First DCA affirmed the final judgment of the trial court, *per curiam*. On June 29, 2015, the plaintiff filed a notice to invoke the discretionary jurisdiction of the Florida Supreme Court. On May 24, 2016, the Florida Supreme Court accepted jurisdiction of the case, quashed the decision of the First DCA, and remanded the case for reconsideration in light of *Soffer*. On September 6, 2016, the First DCA, *per curiam*, reversed and remanded its May 29, 2015 opinion to the trial court for reconsideration in light of the decision in *Soffer*. Retrial is scheduled for February 2018.

On June 14, 2013, in *Skolnick v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Palm Beach County, Fla., filed 2007), a jury found for the plaintiff on the negligence and strict liability claims and for the defendants on the intentional tort claims; awarded $2.56 million in compensatory damages; found the decedent 40% at fault, RJR Tobacco Company 30% at fault and the remaining defendant 30% at fault; and did not reach the issue of entitlement to punitive damages. In July 2013, the trial court entered final judgment against RJR Tobacco Company in the amount of $766,500. On July 15, 2015, the Fourth DCA set aside the judgment and ordered a partial new trial finding that the strict liability and negligence claims, on which the plaintiff had prevailed, were barred by a prior settlement entered into by the plaintiff in a separate action. The Fourth DCA also held that the plaintiff's concealment and conspiracy claims, on which the defendants had prevailed, must be re-tried due to an erroneous jury instruction on the statute of repose. The new trial has not been scheduled.

On September 20, 2013, in *Gafney v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Palm Beach County, Fla., filed 2007), a jury found for the plaintiff on the negligence and strict liability claims and for the defendants on the intentional tort claims; awarded $5.8 million in compensatory damages; found the decedent 34% at fault, RJR Tobacco Company 33% at fault and Lorillard Tobacco 33% at fault; and did not reach the issue of entitlement to punitive damages. In September 2013, the trial court entered final judgment against RJR Tobacco Company in the amount of $1.9 million and against Lorillard Tobacco in the amount of $1.9 million. On March 23, 2016, the Fourth DCA reversed the judgment of the trial court and remanded for a new trial due to improper comments made to the jury during plaintiff's counsel's closing arguments. In August 2016, the Florida Supreme Court declined to accept jurisdiction of the case. The new trial has not been scheduled.

On May 15, 2014, in *Burkhart v. R. J. Reynolds Tobacco Co.* (U.S.D.C. M.D. Fla., filed 2008), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $5 million in compensatory damages; found the plaintiff 50% at fault, RJR Tobacco Company 25% at fault, Lorillard Tobacco 10% at fault and the remaining defendant 15% at fault; and found that the plaintiff was entitled to punitive damages. On May 16, 2014, the jury awarded punitive damages of $1.25 million against RJR Tobacco Company, $500,000 against Lorillard Tobacco, and $750,000 against the remaining defendant. In June 2014, the trial court entered final judgment without a reduction for comparative fault. The defendants appealed to the Eleventh Circuit, RJR Tobacco Company posted a supersedeas bond in the amount of approximately $3.8 million, and Lorillard Tobacco posted a supersedeas bond in the amount of approximately $1.5 million. Oral argument occurred on September 29, 2015. A decision is pending.

On June 23, 2014, in *Bakst v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Palm Beach County, Fla., filed 2007), a case now known as *Odom v. R. J. Reynolds Tobacco Co.*, a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded approximately $6 million in compensatory damages; found the decedent 25% at fault and RJR Tobacco Company 75% at fault; and found that the plaintiff was entitled to punitive damages. On June 23, 2014, the jury awarded $14 million in punitive damages. The trial court later entered final judgment against RJR Tobacco Company in the amount of $4.5 million in compensatory damages and $14 million in punitive damages. RJR Tobacco Company appealed to the Fourth DCA. On November 30, 2016, the Fourth DCA reversed the trial court's judgment and remanded the case with directions that the trial court grant the motion for remittitur or order a new trial on damages only. RJR Tobacco Company filed a motion for rehearing on January 9, 2017, requesting that the Fourth DCA grant rehearing or withdraw the section of its opinion addressing the propriety of the plaintiff's closing argument or grant rehearing *en banc* on the improper

argument issue. On February 27, 2017, the Fourth DCA denied RJR Tobacco Company's motion for rehearing. The plaintiff filed a notice to invoke the discretionary jurisdiction of the Florida Supreme Court on March 27, 2017. A decision is pending.

On July 17, 2014, in *Robinson v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Escambia County, Fla., filed 2008), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $16.9 million in compensatory damages; found the decedent 29.5% at fault and RJR Tobacco Company 70.5% at fault; and found that the plaintiff was entitled to punitive damages. On July 18, 2014, the jury awarded $23.6 billion in punitive damages. In July 2014, the trial court entered partial judgment on compensatory damages against RJR Tobacco Company in the amount of $16.9 million. On January 27, 2015, the trial court remitted the punitive damages award to approximately $16.9 million. In February 2015, RJR Tobacco Company filed an objection to the remitted award of punitive damages and a demand for a new trial on damages. The trial court granted a new trial on the amount of punitive damages only. The new trial on punitive damages has been stayed pending RJR Tobacco Company's appeal to the First DCA of the partial judgment of compensatory damages and of the order granting a new trial on the amount of punitive damages only. On February 24, 2017, the First DCA reversed the judgment of the trial court and remanded the case for a new trial. The new trial has not been scheduled. On May 17, 2017, the First DCA denied the plaintiff's motion for rehearing. The plaintiff filed a notice to invoke the discretionary jurisdiction of the Florida Supreme Court on June 14, 2017. A decision is pending.

On July 31, 2014, in *Harris v. R. J. Reynolds Tobacco Co.* (U.S.D.C. M.D. Fla., filed 2008), a jury found for the plaintiff on the negligence and strict liability claims and for the defendants on the intentional tort claims; awarded $400,000 in compensatory damages for the wrongful death claim and $1.3 million in compensatory damages for the survival claim; allocated fault to the decedent (60% survival/70% wrongful death), RJR Tobacco Company (15% survival/10% wrongful death), Lorillard Tobacco (10% survival/10% wrongful death), and the remaining defendant (15% survival/10% wrongful death), and found that the plaintiff was not entitled to punitive damages. In December 2014, the trial court entered final judgment. Post-trial motions are pending, but in April 2015, the court stayed all post-trial proceedings pending resolution of the petition for *en banc* consideration in *Graham*, described above. On May 31, 2017, the plaintiff asked the court to lift the stay. A decision is pending.

On August 28, 2014, in *Irimi v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Broward County, Fla., filed 2007), a jury found for the plaintiff on the negligence, strict liability, and certain intentional tort claims and for one or more defendants on certain intentional tort claims; awarded approximately $3.1 million in compensatory damages; found the decedent 70% at fault, RJR Tobacco Company 14.5% at fault, Lorillard Tobacco 14.5% at fault and the remaining defendant 1% at fault; and did not reach the issue of entitlement to punitive damages. The trial court entered final judgment against each of RJR Tobacco Company and Lorillard Tobacco in the amount of approximately $453,000 and against the remaining defendant in the amount of approximately $31,000. On January 29, 2015, the court granted the defendants' motion for a new trial. The plaintiff appealed to the Fourth DCA, and the defendants cross appealed. Oral argument occurred on July 12, 2017. A decision is pending.

On October 10, 2014, in *Lourie v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Hillsborough County, Fla., filed 2007), a jury found for the plaintiff on the negligence and strict liability claims and for the defendants on the intentional tort claims; awarded approximately $1.37 million in compensatory damages; found the decedent 63% at fault, RJR Tobacco Company 3% at fault, Lorillard Tobacco 7% at fault and the remaining defendant 27% at fault; and found that the plaintiff was not entitled to punitive damages. The trial court later entered final judgment. The defendants appealed to the Second DCA in November 2014. On August 10, 2016, the Second DCA affirmed the final judgment. The defendants filed a notice to invoke the discretionary jurisdiction of the Florida Supreme Court on September 8, 2016. On June 19, 2017, the Florida Supreme Court denied the defendants' petition for review based on their decision in *Marotta*, described above. The deadline for the defendants to file a petition for writ of certiorari with the U.S. Supreme Court is September 18, 2017.

On October 20, 2014, in *Kerrivan v. R. J. Reynolds Tobacco Co.* (U.S.D.C. M.D. Fla., filed 2008), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $15.8 million in compensatory damages; found the plaintiff 19% at fault, RJR Tobacco Company 31% at fault and the remaining defendant 50% at fault; and found that the plaintiff was entitled to punitive damages. On October 22, 2014, the jury awarded $9.6 million in punitive damages against RJR Tobacco Company and $15.7 million against the remaining defendant. In November 2014, the trial court entered final judgment. RJR Tobacco Company filed its post-trial motions on December 11, 2014. On June 23, 2017, the court lifted the stay that had been in place pending the *en banc* decision in *Graham*, described above, and directed the parties to file supplemental briefs. Briefs have been submitted, and a decision is pending.

On November 18, 2014, in *Schleider v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Miami-Dade County, Fla., filed 2008), a jury found for the plaintiff on the negligence, strict liability, and certain intentional tort claims and for RJR Tobacco Company on certain intentional tort claims, awarded $21 million in compensatory damages, found

the decedent 30% at fault and RJR Tobacco Company 70% at fault, and found that the plaintiff was not entitled to punitive damages. In June 2015, the trial court entered final judgment against RJR Tobacco Company in the amount of $14.7 million. RJR Tobacco Company appealed to the Third DCA and posted a supersedeas bond in the amount of $5 million. Briefing is complete. Oral argument occurred on June 19, 2017. A decision is pending.

On November 21, 2014, in *Perrotto v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Palm Beach County, Fla., filed 2007), a jury found for the plaintiff on the negligence and strict liability claims and for the defendants on the intentional tort claims; awarded $4.1 million in compensatory damages; found the decedent 49% at fault, RJR Tobacco Company 20% at fault, Lorillard Tobacco 6% at fault and the remaining defendant 25% at fault; and did not reach the issue of entitlement to punitive damages. Final judgment was entered against RJR Tobacco Company in the amount of approximately $818,000 and against Lorillard Tobacco in the amount of approximately $245,000. In May 2016, the court granted the plaintiff's motion for a new trial on punitive damages but denied it in all other respects. The new trial is scheduled to begin December 1, 2017.

On December 19, 2014, in *Haliburton v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Palm Beach County, Fla., filed 2008), a jury found that the plaintiff's claims were time-barred, which resulted in a verdict for RJR Tobacco Company. On April 14, 2015, the trial court entered final judgment in favor of RJR Tobacco Company. The plaintiff appealed to the Fourth DCA, and RJR Tobacco Company cross appealed. On February 22, 2017, the Fourth DCA affirmed the judgment of the trial court, *per curiam*. On May 5, 2017, the Fourth DCA denied the plaintiff's motion for written opinion or for certification of a question of great public importance and/or certification of direct conflict to the Florida Supreme Court. The deadline for the plaintiff to file a petition for writ of certiorari with the U.S. Supreme Court is August 3, 2017.

On January 29, 2015, in *Ellen Gray v. R. J. Reynolds Tobacco Co.* (U.S.D.C. M.D. Fla., filed 2008), a jury found for the plaintiff on the negligence and strict liability claims and for RJR Tobacco Company on the intentional tort claims, awarded $6 million in compensatory damages, and found the decedent 50% at fault and RJR Tobacco Company 50% at fault. Although the jury ignored an instruction on the verdict form and found that the plaintiff was entitled to punitive damages, there was no punitive damage award. In February 2015, the trial court entered final judgment against RJR Tobacco Company in the amount of $3 million. Post-trial motions are pending. On June 10, 2015, the court granted RJR Tobacco Company's motion to stay the case pending resolution of the petition for *en banc* consideration in *Graham*, described above. On June 14, 2017, the court lifted the stay and directed the parties to file supplemental briefs. Briefing is complete. A decision is pending.

On February 10, 2015, in *Hecht v. R. J. Reynolds Tobacco Co.* (U.S.D.C. M.D. Fla., filed 2008), a jury found that the plaintiff's claims were time-barred, which resulted in a verdict in favor of RJR Tobacco Company. Post-trial proceedings have been stayed until resolution of the petition for *en banc* consideration in *Graham*, described above. However, the trial court entered final judgment in favor of RJR Tobacco Company on January 7, 2016. On February 2, 2016, the plaintiff appealed to the Eleventh Circuit. Oral argument occurred on January 26, 2017. A decision is pending.

On February 11, 2015, in *Sowers v. R. J. Reynolds Tobacco Co.* (U.S.D.C. M.D. Fla., filed 2008), a jury found for the plaintiff on the negligence and strict liability claims and for RJR Tobacco Company on the intentional tort claims, awarded $4.25 million in compensatory damages, found the decedent 50% at fault and RJR Tobacco Company 50% at fault, and did not reach the issue of entitlement to punitive damages. On February 12, 2015, the trial court entered final judgment against RJR Tobacco Company in the amount of approximately $2.13 million. Post-trial motions are pending. On April 17, 2015, the court stayed post-trial proceedings until resolution of the petition for *en banc* consideration in *Graham*, described above. On June 28, 2017, the court lifted the stay and directed the parties to complete post-trial briefing by August 28, 2017.

On February 24, 2015, in *Caprio v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Broward County, Fla., filed 2007), a jury advised the trial court that it could not reach a unanimous verdict, but the trial court directed the jury to complete the verdict form on those individual verdict questions where there was unanimous agreement. In the partially completed verdict, the jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; found the plaintiff 40% at fault, RJR Tobacco Company 20% at fault, Lorillard Tobacco 10% at fault, and the remaining defendants 30% at fault; and awarded $559,000 in economic damages. The jury did not answer the verdict form questions relating to noneconomic damages and entitlement to punitive damages. In May 2015, the court denied the defendants' motion for a mistrial and advised that it accepted the questions answered by the jurors as a partial verdict. A new trial will be held on the remaining issues, including comparative fault allocation. The defendants appealed to the Fourth DCA. On January 22, 2017, the defendants dismissed their appeal. The case remains pending in the trial court. The new trial is scheduled for August 9, 2017.

On February 26, 2015, in *Zamboni v. R. J. Reynolds Tobacco Co.* (U.S.D.C. M.D. Fla., filed 2008), a jury found for the plaintiff on the negligence and strict liability claims and for the defendants on the intentional tort

claims; awarded the plaintiff $340,000 in compensatory damages; found the decedent 60% at fault, RJR Tobacco Company 30% at fault and the remaining defendant 10% at fault; and did not reach the issue of entitlement to punitive damages. Post-trial motions are pending. The court stayed the case pending resolution of the petition for *en banc* consideration in *Graham*, described above. On June 2, 2017, the plaintiff asked the court to lift the stay. A decision is pending.

On March 23, 2015, in *Pollari v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Broward County, Fla., filed 2007), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $10 million in compensatory damages; found the decedent 15% at fault, RJR Tobacco Company 42.5% at fault and the remaining defendant 42.5% at fault; and found that the plaintiff was entitled to punitive damages. On March 25, 2015, the jury awarded $1.5 million in punitive damages against each defendant. The trial court later entered final judgment against the defendants in the amount of $10 million in compensatory damages and, against each defendant, $1.5 million in punitive damages. On January 12, 2016, the trial court entered a second amended final judgment against RJR Tobacco Company that awarded $4.25 million in compensatory damages and $1.5 million in punitive damages. The defendants appealed to the Fourth DCA, RJR Tobacco Company posted a supersedeas bond in the amount of $2.5 million, and the plaintiff cross appealed. Oral argument occurred on June 27, 2017. A decision is pending.

On March 26, 2015, in *Gore v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Indian River County, Fla., filed 2008), a jury, in a retrial following a mistrial, found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $2 million in compensatory damages; found the decedent 54% at fault, RJR Tobacco Company 23% at fault and the remaining defendant 23% at fault; and found that the plaintiff was not entitled to punitive damages. In September 2015, the trial court entered final judgment against RJR Tobacco Company and the remaining defendant, each in the amount of $460,000. RJR Tobacco Company posted a supersedeas bond in the amount of $460,000 in September 2015, and in October 2015, the defendants appealed to the Fourth DCA, and the plaintiff cross appealed. Briefing is complete. Oral argument has not been scheduled.

On April 17, 2015, in *Ryan v. R. J. Reynolds Tobacco Co*. (Cir. Ct. Broward County, Fla., filed 2007), a jury, in a retrial following a mistrial, found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $21.5 million in compensatory damages; found the plaintiff 35% at fault and RJR Tobacco Company 65% at fault; and found that the plaintiff was entitled to punitive damages. On April 21, 2015, the jury awarded $25 million in punitive damages. In May 2015, the trial court entered final judgment against RJR Tobacco Company in the amount of $21.5 million in compensatory damages and $25 million in punitive damages. On April 29, 2016, the court entered an amended final judgment against RJR Tobacco Company in the amount of approximately $14 million in compensatory damages and $25 million in punitive damages. RJR Tobacco Company filed a notice of appeal to the Fourth DCA and posted a supersedeas bond in the amount of $5 million on May 27, 2016. The plaintiff filed a notice of cross appeal on June 13, 2016. Briefing is complete. Oral argument has not been scheduled.

On June 18, 2015, in *Hardin v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Miami-Dade County, Fla., filed 2007), a jury found for the plaintiff on the negligence and strict liability claims and for RJR Tobacco Company on the intentional tort claims, awarded $776,000 in compensatory damages, found the decedent 87% at fault and RJR Tobacco Company 13% at fault, and found that the plaintiff was not entitled to punitive damages. In June 2015, the trial court entered final judgment against RJR Tobacco Company in the amount of $100,880. The plaintiff appealed to the Third DCA, and RJR Tobacco Company cross appealed. On December 21, 2016, the Third DCA remanded the case for a new trial limited to the issue of punitive damages for the plaintiff's non-intentional tort claims. Otherwise, the final judgment was affirmed. Neither party sought further review. The new trial is scheduled to begin August 21, 2017.

On July 13, 2015, in *McCoy v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Broward County, Fla., filed 2007), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $1.5 million in compensatory damages; found the decedent 35% at fault, RJR Tobacco Company 25% at fault, Lorillard Tobacco 20% at fault and the remaining defendant 20% at fault; and found that the plaintiff was entitled to punitive damages. On July 17, 2015, the jury awarded $3 million in punitive damages against each defendant. In August 2015, the trial court entered final judgment against RJR Tobacco Company, RJR Tobacco Company as successor-by-merger to Lorillard Tobacco, and the remaining defendant, jointly and severally, in the amount of $1.5 million in compensatory damages and, against each of them, $3 million in punitive damages. On January 4, 2016, the trial court entered an amended final judgment in the amount of $370,000 in compensatory damages and $3 million in punitive damages against RJR Tobacco Company, $300,000 in compensatory damages and $3 million in punitive damages against RJR Tobacco Company as successor-by-merger to Lorillard Tobacco, and $300,000 in compensatory damages and $3 million in punitive damages against the remaining defendant. RJR Tobacco Company appealed to the Fourth DCA and posted a supersedeas bond in the amount of approximately $3.35 million, and the plaintiff filed a notice of cross appeal. Oral argument is scheduled for September 26, 2017.

On July 29, 2015, in *Collar v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Indian River County, Fla., filed 2008), a jury found that the plaintiff was not a class member, which resulted in a verdict for the defendants, including RJR Tobacco Company. In September 2015, the trial court entered final judgment. The plaintiff appealed to the Fourth DCA, and the defendants cross appealed. Oral argument occurred on June 13, 2017. On July 5, 2017, the Fourth DCA reversed the judgment of the trial court and remanded the case for a new trial. The deadline for the defendants to file a notice to invoke the discretionary jurisdiction of the Florida Supreme Court is August 4, 2017.

On August 6, 2015, in *Block v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Broward County, Fla., filed 2007), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded approximately $1.03 million in compensatory damages; found the decedent 50% at fault and RJR Tobacco Company 50% at fault; and found that the plaintiff was entitled to punitive damages. On August 7, 2015, the jury awarded $800,000 in punitive damages. In September 2015, the trial court entered final judgment against RJR Tobacco Company in the amount of approximately $926,000 in compensatory damages and $800,000 in punitive damages. On December 9, 2015, the trial court granted RJR Tobacco Company's motion to alter or amend the judgment in part in light of the Fourth DCA's decision in *Schoeff v. R. J. Reynolds Tobacco Co.*, described above, finding that the intentional tort exception in Section 768.81, Florida Statutes, does not apply to the fraud and conspiracy claims brought by *Engle* Progeny plaintiffs. As a result, an amended final judgment was entered in the amount of approximately $463,000 in compensatory damages and $800,000 in punitive damages. RJR Tobacco Company appealed to the Fourth DCA and posted a supersedeas bond in the amount of approximately $1.3 million, and the plaintiff filed a notice of cross appeal. On February 3, 2017, the Fourth DCA entered an order dispensing with oral argument. On April 27, 2017, the Fourth DCA affirmed the judgment of the trial court, *per curiam.* The deadline for RJR Tobacco Company to file a petition for writ of certiorari with the U.S. Supreme Court is September 22, 2017.

On September 1, 2015, in *Lewis v. R. J. Reynolds Tobacco Co*. (Cir. Ct. Volusia County, Fla., filed 2007), a jury found for the plaintiff on the negligence and strict liability claims and for RJR Tobacco Company on the intentional tort claims, awarded $750,000 in compensatory damages, found the decedent 75% at fault and RJR Tobacco Company 25% at fault, and found that the plaintiff was not entitled to punitive damages. Final judgment was entered against RJR Tobacco Company in the amount of $187,500 in March 2016. RJR Tobacco Company appealed to the Fifth DCA and posted a supersedeas bond in the amount of $187,500. On May 2, 2017, the Fifth DCA affirmed the final judgment of the trial court, *per curiam*. The deadline for RJR Tobacco Company to file a petition for writ of certiorari with the U.S. Supreme Court is September 29, 2017.

On September 8, 2015, in *Cooper v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Broward County, Fla., filed 2007), a jury found for the plaintiff on the negligence and strict liability claims and for the defendants on the intentional tort claims; awarded $4.5 million in compensatory damages; found the plaintiff 50% at fault, RJR Tobacco Company 40% at fault and the remaining defendant 10% at fault; and did not reach the issue of entitlement to punitive damages. Post-trial motions were denied on December 2, 2015. In February 2016, the trial court entered final judgment against RJR Tobacco Company in the amount of approximately $1.2 million. The defendants appealed to the Fourth DCA, and the plaintiff cross appealed. RJR Tobacco Company posted a supersedeas bond in the amount of approximately $1.2 million. Briefing is complete. Oral argument has not been scheduled.

On September 10, 2015, in *Duignan v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Pinellas County, Fla., filed 2007), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $6 million in compensatory damages; found the decedent 33% at fault, RJR Tobacco Company 30% at fault, and the remaining defendant 37% at fault; and found that the plaintiff was entitled to punitive damages. On September 11, 2015, the jury awarded $2.5 million in punitive damages against RJR Tobacco Company and $3.5 million in punitive damages against the remaining defendant. The trial court later entered final judgment against RJR Tobacco Company and the remaining defendant in the amount of $6 million in compensatory damages and $2.5 million in punitive damages against RJR Tobacco Company and $3.5 million in punitive damages against the remaining defendant. The defendants appealed to the Second DCA, and RJR Tobacco Company posted a supersedeas bond in the amount of approximately $2.3 million. Oral argument occurred on December 5, 2016. A decision is pending.

On September 10, 2015, in *O'Hara v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Escambia County, Fla., filed 2007), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $14.7 million in compensatory damages; found the decedent 15% at fault and RJR Tobacco Company 85% at fault; and found that the plaintiff was entitled to punitive damages. On September 11, 2015, the jury awarded $20 million in punitive damages. In September 2015, the trial court entered final judgment against RJR Tobacco Company in the amount of $14.7 million in compensatory damages and $20 million in punitive damages. RJR Tobacco Company appealed to the First DCA and posted a supersedeas bond in the amount of $5 million. Oral argument occurred on May 10, 2017. A decision is pending.

On September 22, 2015, in *Suarez v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Miami-Dade County, Fla., filed 2008), a jury found that the decedent was not a class member, which resulted in a verdict for the defendants, including RJR Tobacco Company. In November 2015, the trial court entered final judgment. The plaintiff appealed to the Third DCA, and the defendants cross appealed. On October 19, 2016, the Third DCA affirmed the judgment of the trial court, *per curiam*. On October 27, 2016, the plaintiff filed a motion for a written opinion and certification to the Florida Supreme Court, which was denied on May 19, 2017. The deadline for the plaintiff to file a petition for writ of certiorari with the U.S. Supreme Court is August 17, 2017.

On October 2, 2015, in *Marchese v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Broward County, Fla., filed 2007), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $1 million in compensatory damages; found the decedent 55% at fault, RJR Tobacco Company 22.5% at fault, and the remaining defendant 22.5% at fault; and found that the plaintiff was entitled to punitive damages. On October 6, 2015, the jury awarded $250,000 in punitive damages against each defendant. Final judgment was entered on November 5, 2015. On May 17, 2016, an amended final judgment was entered in the amount of $450,000 in compensatory damages against RJR Tobacco Company and the remaining defendant, jointly and severally, and $250,000 in punitive damages against each defendant. RJR Tobacco Company appealed to the Fourth DCA and posted a supersedeas bond in the amount of $475,000. Briefing is complete. Oral argument has not been scheduled.

On November 17, 2015, in *Barbose v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Pasco County, Fla., filed 2007), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $10 million in compensatory damages, found the decedent 15% at fault, RJR Tobacco Company 42.5% at fault and the remaining defendant 42.5% at fault; and found that the plaintiff was entitled to punitive damages. On November 18, 2015, the jury awarded $500,000 in punitive damages against each of RJR Tobacco Company and the other defendant. The defendants appealed to the Second DCA, and RJR Tobacco Company posted a supersedeas bond in the amount of $2.5 million. Oral argument is scheduled for August 8, 2017.

On November 20, 2015, in *Fanali v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Palm Beach County, Fla., filed 2008), a jury found that cigarette smoking was not a legal cause of the decedent's coronary artery disease and death, which resulted in a verdict for RJR Tobacco Company. On December 17, 2015, the trial court entered final judgment in favor of RJR Tobacco Company. The plaintiff appealed to the Fourth DCA, and RJR Tobacco Company cross appealed. On June 21, 2017, the Fourth DCA affirmed the final judgment of the trial court. On July 13, 2017, the plaintiff filed a motion for rehearing and filed an amended motion for rehearing on July 14, 2017. A decision is pending.

On November 24, 2015, in *Green v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Miami-Dade County, Fla., filed 2007), a jury found that the plaintiff does not have chronic obstructive pulmonary disease, which resulted in a verdict for RJR Tobacco Company. Post-trial motions were denied on March 23, 2016. On April 4, 2016, final judgment was entered in favor of RJR Tobacco Company. The plaintiff appealed to the Third DCA, and RJR Tobacco Company cross appealed. On May 3, 2017, the Third DCA affirmed the final judgment of the trial court, *per curiam*. The plaintiff did not seek further review.

On December 9, 2015, in *Monroe v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Gadsden County, Fla., filed 2007), a jury found for the plaintiff on the negligence and strict liability claims and for RJR Tobacco Company on the intentional tort claims, awarded $11 million in compensatory damages, found the plaintiff 42% at fault and RJR Tobacco Company 58% at fault, and did not reach the issue of entitlement to punitive damages. On December 31, 2015, the trial court entered final judgment against RJR Tobacco Company in the amount of $6.38 million in compensatory damages. RJR Tobacco Company appealed to the First DCA and posted a supersedeas bond in the amount of $5 million. On March 23, 2017, the First DCA affirmed the judgment of the trial court, *per curiam*. On April 19, 2017, RJR Tobacco Company filed a notice to invoke the discretionary jurisdiction of the Florida Supreme Court. On June 13, 2017, the Florida Supreme Court declined to accept jurisdiction. The deadline for RJR Tobacco Company to file a petition for writ of certiorari with the U.S. Supreme Court is September 11, 2017.

On December 18, 2015, in *Ledoux v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Miami-Dade County, Fla., filed 2007), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $10 million in compensatory damages; found the decedent 6% at fault, RJR Tobacco Company 47% at fault and the remaining defendant 47% at fault; and found that the plaintiff was entitled to punitive damages. On December 22, 2015, the jury awarded $12.5 million in punitive damages against each defendant. The trial court later entered final judgment against the defendants, jointly and severally, in the amount of $10 million in compensatory damages and, against each defendant, $12.5 million in punitive damages. The defendants appealed to the Third DCA, and RJR Tobacco Company posted a supersedeas bond in the amount of $5 million. On

May 27, 2016, RJR Tobacco Company filed a rider amending the supersedeas bond reducing the amount from $5 million to $2.5 million. Oral argument occurred on April 11, 2017. A decision is pending.

On January 26, 2016, in *Ewing v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Escambia County, Fla., filed 2008), a jury found for the plaintiff on the negligence and strict liability claims and for the defendants on the intentional tort claims; awarded $240,000 in compensatory damages; found the decedent 98% at fault, RJR Tobacco Company 2% at fault and the remaining defendant 0% at fault, and did not reach the issue of entitlement to punitive damages. Post-trial motions were denied on February 25, 2016. Final judgment has not been entered.

On February 12, 2016, in *Ahrens v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Pinellas County, Fla., filed 2008), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $9 million in compensatory damages; found the decedent 32% at fault, RJR Tobacco Company 44% at fault, and the remaining defendant 24% at fault; and found that the plaintiff was entitled to punitive damages. On February 13, 2016, the jury awarded $2.5 million in punitive damages against each defendant. In February 2016, the trial court entered final judgment. On April 13, 2016, RJR Tobacco Company appealed to the Second DCA and posted a supersedeas bond in the amount of $2.5 million. On May 12, 2017, the Second DCA affirmed the final judgment of the trial court, *per curiam*. On May 24, 2017, the defendants filed a motion for a written opinion or citation. On July 14, 2017, the Second DCA granted the defendants' motion for a written opinion, withdrew the May 12, 2017 decision and substituted the July 14, 2017 opinion, which affirmed the final judgment in all respects without further discussion while certifying a conflict to the Florida Supreme Court on the application of comparative fault. The deadline for the defendants to file a notice to invoke the discretionary jurisdiction of the Florida Supreme Court is August 11, 2017.

On March 8, 2016, in *Gamble v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Duval County, Fla., filed 2008), a jury found for the plaintiff on class membership, but found for RJR Tobacco Company on addiction causation, which resulted in a verdict for RJR Tobacco Company. Final judgment was entered in favor of RJR Tobacco Company on June 9, 2016. The plaintiff appealed to the First DCA on July 8, 2016. Briefing is complete. Oral argument has not been scheduled.

On April 7, 2016, in *Davis v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Miami-Dade County, Fla., filed 2008), a jury found for the plaintiff on class membership, but found for RJR Tobacco Company on addiction causation, which resulted in a verdict for RJR Tobacco Company. On August 17, 2016, the court granted the plaintiff's motion for a new trial. RJR Tobacco Company filed a notice of appeal to the Third DCA on August 25, 2016. Oral argument is scheduled for August 16, 2017.

On April 21, 2016, in *Turner v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Broward County, Fla., filed 2007), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $3 million in compensatory damages; found the decedent 20% at fault and RJR Tobacco Company 80% at fault; and found that the plaintiff was entitled to punitive damages. On April 22, 2016, the jury awarded $10 million in punitive damages. The court entered judgment against RJR Tobacco Company in the amount of $2.4 million in compensatory damages and $10 million in punitive damages. In July 2016, RJR Tobacco Company filed a notice of appeal to the Fourth DCA and posted a supersedeas bond in the amount of $5 million. The plaintiff filed a notice of cross appeal in August 2016. Oral argument occurred on July 25, 2017. A decision is pending.

On April 26, 2016, in *Enochs v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Palm Beach County, Fla., filed 2007), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $21 million in compensatory damages; found the decedent 22% at fault, RJR Tobacco Company 66% at fault and the remaining defendant 12% at fault; and found that the plaintiff was entitled to punitive damages. On April 27, 2016, the jury awarded $6.25 million in punitive damages against each defendant. Final judgment was entered against RJR Tobacco Company in the amount of approximately $13.9 million in compensatory damages and $6.25 million in punitive damages on May 9, 2016. The defendants appealed to the Fourth DCA, and RJR Tobacco Company posted a supersedeas bond in the amount of approximately $3.5 million. Oral argument occurred on July 18, 2017. A decision is pending.

On May 11, 2016, in *Dion v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Sarasota County, Fla., filed 2007), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $12 million in compensatory damages; found the decedent 25% at fault and RJR Tobacco Company 75% at fault; and found that the plaintiff was entitled to punitive damages. On May 12, 2016, the jury awarded $30,000 in punitive damages. On August 9, 2016, RJR Tobacco Company filed a notice of appeal to the Second DCA and posted a supersedeas bond in the amount of $5 million. Oral argument is scheduled for September 28, 2017.

On May 16, 2016, in *Nally v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Polk County, Fla., filed 2007), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $6 million in compensatory damages; found the decedent 25% at fault and RJR Tobacco Company 75% at fault; and found

that the plaintiff was entitled to punitive damages. On May 17, 2016, the jury awarded $12 million in punitive damages. Final judgment was entered against RJR Tobacco Company in the amount of $6 million in compensatory damages and $12 million in punitive damages on May 25, 2016. In September 2016, RJR Tobacco Company filed a notice of appeal to the Second DCA and posted a supersedeas bond in the amount of $5 million. Briefing is underway.

On May 19, 2016, in *McCabe v. R. J. Reynolds Tobacco Co*. (Cir. Ct. Hillsborough County, Fla., filed 2007), a jury found for the plaintiff on the negligence and strict liability claims, awarded $5 million in compensatory damages, found the decedent 70% at fault and RJR Tobacco Company 30% at fault, and found that the plaintiff was entitled to punitive damages. On May 20, 2016, the jury awarded $6.5 million in punitive damages. Final judgment was entered against RJR Tobacco Company in the amount of $1.5 million in compensatory damages and $6.5 million in punitive damages on May 31, 2016. Post-trial motions were denied on January 26, 2017. On February 24, 2017, RJR Tobacco Company filed a notice of appeal to the Second DCA. RJR Tobacco Company posted a supersedeas bond in the amount of $5 million on February 27, 2017. Briefing is underway.

On June 21, 2016, in *Mooney v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Miami-Dade County, Fla., filed 2008), a jury found that the decedent's addiction to nicotine was not a legal cause of her death, which resulted in a verdict for the defendants, including RJR Tobacco Company. Final judgment has not been entered.

On July 1, 2016, in *Sermons v. Philip Morris USA Inc.* (Cir. Ct. Duval County, Fla., filed 2008), a jury found for the plaintiff on the negligence and strict liability claims; awarded $65,000 in compensatory damages; found the decedent 80% at fault, RJR Tobacco Company 5% at fault, and the remaining defendant 15% at fault; and found that the plaintiff was entitled to punitive damages. On July 6, 2016, the jury awarded $17,075 in punitive damages against RJR Tobacco Company and $51,225 in punitive damages against the remaining defendant. Post-trial motions are pending.

On August 5, 2016, in *Morales v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Miami-Dade County, Fla., filed 2007), the court declared a mistrial because a death in a juror's family prevented the juror from deliberating. The new trial was scheduled for January 9, 2017, but has since been removed from the trial calendar.

On August 15, 2016, in *Mathis v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Miami-Dade County, Fla., filed 2007), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $5 million in compensatory damages; found the decedent 45% at fault and RJR Tobacco Company 55% at fault; and found that the plaintiff was not entitled to punitive damages. Final judgment was entered on August 17, 2016. RJR Tobacco Company filed a notice of appeal to the Third DCA and posted a supersedeas bond in the amount of $5 million on November 18, 2016. Briefing is underway.

On August 18, 2016, in *Wilkins v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Miami-Dade County, Fla., filed 2007), a jury found that the decedent was not a class member, which resulted in a verdict for RJR Tobacco Company. Final judgment was entered in favor of RJR Tobacco Company on November 16, 2016. The plaintiff filed a notice of appeal to the Third DCA on December 16, 2016, and RJR Tobacco Company filed a notice of cross appeal on December 21, 2016. The parties dismissed their respective appeals in April 2017.

On August 25, 2016, in *Coursey v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Volusia County, Fla., filed 2007), a jury found that the decedent was not a class member, which resulted in a verdict for RJR Tobacco Company. Final judgment was entered in RJR Tobacco Company's favor on September 27, 2016. On October 27, 2016, the plaintiff filed a notice of appeal to the Fifth DCA. RJR Tobacco Company filed a notice of cross appeal on November 8, 2016. Briefing is underway.

On September 6, 2016, in *Hackimer v. R. J. Reynolds Tobacco Co*. (Cir. Ct. Palm Beach County, Fla., filed 2007), a jury found that the deceased smoker knew or should have known of his chronic obstructive pulmonary disease before May 5, 1990, and, for that reason, the claims were barred by the statute of limitations, which resulted in a verdict for RJR Tobacco Company. On January 4, 2017, final judgment was entered in favor of RJR Tobacco Company. The plaintiff filed a notice of appeal to the Fourth DCA on February 1, 2017. RJR Tobacco Company filed a notice of cross appeal on February 9, 2017. Briefing is underway.

On September 22, 2016, in *Oshinsky-Blacker v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Broward County, Fla., filed 2007), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $6.15 million in compensatory damages; found the decedent 15% at fault, RJR Tobacco Company 25% at fault, and the remaining defendant 60% at fault; and found that the plaintiff was entitled to punitive damages. On September 23, 2016, the jury awarded $2 million in punitive damages against RJR Tobacco Company and $1 million in punitive damages against the remaining defendant. On March 6, 2017, the court granted the defendants' motion for a new trial. The new trial has not been scheduled. The plaintiff filed a notice of appeal to

the Fourth DCA on March 24, 2017. The defendants filed a notice of cross appeal on March 31, 2017. Briefing is underway.

On September 23, 2016, in *Sherry Smith v. R. J. Reynolds Tobacco Co*. (Cir. Ct. Volusia County, Fla., filed 2008), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $3 million in compensatory damages; found the decedent 35% at fault and RJR Tobacco Company 65% at fault; and found that the plaintiff was not entitled to punitive damages. Final judgment was entered against RJR Tobacco Company in the amount of $3 million. In January 2017, RJR Tobacco Company filed a notice of appeal to the Fifth DCA and posted a supersedeas bond in the amount of $3 million. Briefing is underway.

On September 28, 2016, in *Prentice v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Duval County, Fla., filed 2007), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $6.4 million in compensatory damages; found the decedent 60% at fault and RJR Tobacco Company 40% at fault; and found that the plaintiff was entitled to punitive damages. On September 29, 2016, the jury awarded $0 in punitive damages. Post-trial motions were denied on April 11, 2017, and final judgment was entered against RJR Tobacco Company in the amount of $6.4 million. RJR Tobacco Company filed a notice of appeal to the First DCA on May 11, 2017, and the plaintiff filed a notice of cross appeal on May 19, 2017. Briefing is underway.

On October 24, 2016, in *Konzelman v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Broward County, Fla., filed 2007), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded approximately $8.8 million in compensatory damages; found the decedent 15% at fault and RJR Tobacco Company 85% at fault; and found that the plaintiff was entitled to punitive damages. On October 26, 2016, the jury awarded $20 million in punitive damages. On December 1, 2016, the trial court entered final judgment against RJR Tobacco Company in the amount of approximately $7.48 million in compensatory damages and $20 million in punitive damages. RJR Tobacco Company filed a notice of appeal to the Fourth DCA and posted a supersedeas bond in the amount of $5 million on December 22, 2016. The plaintiff filed a notice of cross appeal on January 2, 2017. Briefing is underway.

On November 2, 2016, in *Johnston v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Sarasota County, Fla., filed 2007), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $7.5 million in compensatory damages; found the decedent 10% at fault and RJR Tobacco Company 90% at fault; and found that the plaintiff was entitled to punitive damages. On November 5, 2016, the jury awarded $14 million in punitive damages. Final judgment was entered against RJR Tobacco Company in the amount of $6.75 million in compensatory damages and $14 million in punitive damages on November 28, 2016. Post-trial motions were denied on March 30, 2017. RJR Tobacco Company filed a notice of appeal to the Second DCA on April 25, 2017, and posted a supersedeas bond in the amount of $5 million on April 26, 2017. The plaintiff filed a notice of cross appeal on May 17, 2017. Briefing is underway.

On November 3, 2016, in *Ledo v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Miami-Dade County, Fla., filed 2008), a jury found for the plaintiff on the negligence and strict liability claims and for RJR Tobacco Company on the intentional tort claims; awarded $6 million in compensatory damages; found the decedent 51% at fault and RJR Tobacco Company 49% at fault; and found that the plaintiff was entitled to punitive damages. After receiving the verdict, the trial court granted a directed verdict in favor of RJR Tobacco Company on entitlement to punitive damages. Final judgment was entered against RJR Tobacco Company in the amount of $2.94 million in compensatory damages on December 22, 2016. Post-trial motions are pending.

On November 10, 2016, in *Howles v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Broward County, Fla., filed 2007), a jury found for the plaintiff on the negligence, strict liability and intentional tort claims; awarded $4 million in compensatory damages; found RJR Tobacco Company 50% at fault and the remaining defendant 50% at fault; and found that the plaintiff was entitled to punitive damages. On November 14, 2016, the jury awarded $3 million in punitive damages against RJR Tobacco Company and $3 million against the remaining defendant. Final judgment was entered against RJR Tobacco Company in the amount of $2 million in compensatory damages and $3 million in punitive damages. On December 30, 2016, the defendants filed a joint notice of appeal to the Fourth DCA. Briefing is underway.

On November 16, 2016, in *Ford v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Palm Beach County, Fla., filed 2008), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded approximately $1.02 million in compensatory damages; found the plaintiff 85% at fault and RJR Tobacco Company 15% at fault; and found that the plaintiff was not entitled to punitive damages. The trial court entered final judgment against RJR Tobacco Company in the amount of approximately $153,400 on March 13, 2017. Post-trial motions were denied on June 6, 2017. On June 12, 2017, the plaintiff filed a notice of appeal to the Fourth DCA. RJR Tobacco Company filed a notice of cross appeal on June 21, 2017. Briefing is underway.

On November 16, 2016, in *Stanley Martin v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Broward County, Fla., filed 2007), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded

approximately $5.41 million in compensatory damages; found the decedent 32% at fault, RJR Tobacco Company 22% at fault and the remaining defendant 46% at fault; and found that the plaintiff was entitled to punitive damages. On November 18, 2016, the jury awarded $200,000 in punitive damages against RJR Tobacco Company and $450,000 against the remaining defendant. Final judgment was entered against RJR Tobacco Company in the amount of approximately $1.2 million in compensatory damages and $200,000 in punitive damages and against the remaining defendant in the amount of $2.5 million in compensatory damages and $450,000 in punitive damages. Post-trial motions were denied on January 26, 2017. On February 23, 2017, the defendants filed a joint notice of appeal to the Fourth DCA, and RJR Tobacco Company posted a supersedeas bond in the amount of approximately $1.4 million. The plaintiff filed a notice of cross appeal on February 24, 2017. Briefing is underway.

On December 16, 2016, in *Dubinsky v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Brevard County, Fla., filed 2008), a jury found that the decedent was not a class member, which resulted in a verdict for the defendants, including RJR Tobacco Company. Final judgment was entered in favor of the defendants on April 3, 2017. The plaintiff did not seek further review.

On December 16, 2016, in *Pardue v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Alachua County, Fla., filed 2008), a jury, in a retrial following a mistrial, found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded approximately $5.9 million in compensatory damages; found the decedent 25% at fault, RJR Tobacco Company 50% at fault, and the remaining defendant 25% at fault; and found that the plaintiff was entitled to punitive damages. On December 19, 2016, the jury awarded $6.75 million in punitive damages against RJR Tobacco Company and $6.75 million in punitive damages against the remaining defendant. Final judgment was entered against RJR Tobacco Company in the amount of approximately $5.9 million in compensatory damages (jointly and severally with the remaining defendant) and, against each defendant, $6.75 million in punitive damages on December 29, 2016. An amended final judgment was entered against RJR Tobacco Company in the amount of approximately $5.2 million in compensatory damages (jointly and severally with the remaining defendant) and, against each defendant, $6.75 million in punitive damages. Post-trial motions were denied on April 19, 2017. On March 8, 2017, the defendants filed a notice of appeal to the First DCA, and RJR Tobacco Company posted a supersedeas bond in the amount of $2.5 million on March 9, 2017. Briefing is underway.

On February 8, 2017, in *Durrance v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Highlands County, Fla., filed 2011), a jury found that the decedent knew or should have known of her chronic obstructive pulmonary disease before May 5, 1990, which resulted in a verdict for RJR Tobacco Company. Final judgment was entered in favor of RJR Tobacco Company on April 26, 2017. On May 16, 2017, the plaintiff filed a notice of appeal to the Second DCA. RJR Tobacco Company filed a notice of cross appeal on May 17, 2017. Briefing is underway.

On February 15, 2017, in *John Brown v. Philip Morris USA Inc.* (Cir. Ct. Pinellas County, Fla., filed 2007), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $5.4 million in compensatory damages; found the decedent 30% at fault, RJR Tobacco Company 35% at fault and the remaining defendant 35% at fault; and found that the plaintiff was entitled to punitive damages. On February 17, 2017, the jury awarded $200,000 each in punitive damages against RJR Tobacco Company and the remaining defendant. Post-trial motions are pending.

On February 23, 2017, in *Nixon v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Palm Beach County, Fla., filed 2007), the court declared a mistrial due to the inability to seat a jury. Retrial has not been scheduled.

On February 23, 2017, in *Fox v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Broward County, Fla., filed 2007), a jury found for the plaintiff on the negligence and strict liability claims and for RJR Tobacco Company on the intentional tort claims; awarded $6 million in compensatory damages; found the decedent 50% at fault and RJR Tobacco Company 50% at fault; and found that the plaintiff was not entitled to punitive damages. Post-trial motions were denied on May 3, 2017, and final judgment was entered against RJR Tobacco Company in the amount of $3 million. RJR Tobacco Company filed a notice of appeal to the Fourth DCA on July 24, 2017. Briefing is underway.

On March 16, 2017, in *Theis v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Sarasota County, Fla., filed 2007), the court declared a mistrial due to the inability to seat a jury. Retrial is scheduled to begin June 4, 2018.

On March 28, 2017, in *Whitmire v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Leon County, Fla., filed 2008), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $3 million in compensatory damages; found the decedent 33% at fault and RJR Tobacco Company 67% at fault; and found that the plaintiff was entitled to punitive damages. On March 29, 2017, the court declared a mistrial in the punitive damages phase because the jury was deadlocked. On April 6, 2017, final judgment was entered against RJR Tobacco Company in the amount of $3 million in compensatory damages. Post-trial motions were denied on

April 19, 2017. RJR Tobacco Company filed a notice of appeal to the First DCA on May 15, 2017, and posted a supersedeas bond in the amount of $3 million on June 6, 2017. Briefing is underway.

On March 29, 2017, in *Santoro v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Broward County, Fla., filed 2007), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded approximately $1.6 million in compensatory damages; found the decedent 36% at fault, RJR Tobacco Company 26% at fault, and the remaining defendants 38% at fault; and found that the plaintiff was entitled to punitive damages. On March 31, 2017, the jury awarded $90,000 in punitive damages against RJR Tobacco Company and $115,000 against the remaining defendants. On April 5, 2017, an amended final judgment was entered against RJR Tobacco Company in the amount of $507,300 and against the remaining defendant in the amount of $724,900. Post-trial motions are pending.

On April 18, 2017, in *Schlefstein v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Broward County, Fla., filed 2007), the court declared a mistrial during jury selection. Retrial has been scheduled for January 16, 2018.

On April 20, 2017, in *Lima v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Hillsborough County, Fla., filed 2007), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $3 million in compensatory damages; found the decedent 40% at fault, RJR Tobacco Company 60% at fault, and the remaining defendant 0% at fault; and found that the plaintiff was entitled to punitive damages with respect to RJR Tobacco Company and that the plaintiff was not entitled to punitive damages with respect to the other defendant. On April 21, 2017, the jury awarded $12 million in punitive damages against RJR Tobacco Company. Final judgment was entered against RJR Tobacco Company in the amount of $1.8 million in compensatory damages and $12 million in punitive damages on April 25, 2017. Post-trial motions are pending.

On April 24, 2017, in *Shadd v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Palm Beach County, Fla., filed 2007), a jury found for the plaintiff on the negligence and strict liability claims and for RJR Tobacco Company on the intentional tort claims; awarded $0 in compensatory damages; found that the decedent was 95% at fault and RJR Tobacco Company 5% at fault; and found that the plaintiff was not entitled to punitive damages. Post-trial motions are pending.

On May 9, 2017, in *Lawrence v. R. J. Reynolds Tobacco Co*. (Cir. Ct. Marion County, Fla., filed 2007), a jury found for the plaintiff on the negligence and strict liability claims and for RJR Tobacco Company on the intentional tort claims; awarded approximately $858,200 in compensatory damages; found the decedent was 65% at fault and RJR Tobacco Company 35% at fault, and found that the plaintiff was entitled to punitive damages. Prior to the punitive damages phase, the parties resolved the matter. Final judgment was entered against RJR Tobacco Company in the amount of approximately $300,000. RJR Tobacco Company paid approximately $2.9 million on June 29, 2017 in satisfaction of the judgment (including fees and interest).

On May 11, 2017, in *Sheffield v. R. J. Reynolds Tobacco Co*. (Cir. Ct. Orange County, Fla., filed 2007), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims: awarded $1.8 million in compensatory damages; found the decedent 40% at fault and RJR Tobacco Company 60% at fault; and found that the plaintiff was entitled to punitive damages. On May 12, 2017, the jury awarded $5 million in punitive damages against RJR Tobacco Company. Post-trial motions were denied on July 10, 2017, and final judgment was entered against RJR Tobacco Company in the amount of $1.8 million in compensatory damages and $5 million in punitive damages. The deadline for RJR Tobacco Company to file a notice of appeal to the Fifth DCA is August 9, 2017.

On May 23, 2017, in *Olson v. R. J. Reynolds Tobacco Co*. (Cir. Ct. Duval County, Fla., filed 2008), the court granted RJR Tobacco Company's motions for a mistrial due to an error with the instructions provided to the jury. Retrial is scheduled for August 6, 2018.

On June 2, 2017, in *Kogan v. R. J. Reynolds Tobacco Co*. (Cir. Ct. Palm Beach County, Fla., filed 2007), a jury found that an addiction to cigarettes containing nicotine was not the legal cause of the plaintiff's bladder cancer, which resulted in a verdict for the defendants, including RJR Tobacco Company. Final judgment was entered on June 22, 2017. On July 18, 2017, the plaintiff filed a notice of appeal to the Fourth DCA. Briefing is underway.

On June 7, 2017, in *Gay v. R. J. Reynolds Tobacco Co*. (Cir. Ct. Hillsborough County, Fla., filed 2007), the court declared a mistrial due to comments made by a prospective juror during jury selection. Retrial is rescheduled tentatively for September 8, 2017.

On July 18, 2017, in *Maloney v. R. J. Reynolds Tobacco Co*. (Cir. Ct. Lee County, Fla., filed 2007), a jury found for the plaintiff on the negligence, strict liability and intentional tort claims; awarded $1.65 million in compensatory damages; found the decedent 50% at fault and RJR Tobacco Company 50% at fault; and found that the plaintiff was not entitled to punitive damages. Post-trial motions are pending.

On July 28, 2017, in *Thomas v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Broward County, Fla., filed 2007), a jury found for the plaintiff on the negligence, strict liability and intentional tort claims; awarded $4 million in compensatory damages; found the decedent 45% at fault and RJR Tobacco Company 55% at fault; and found that the plaintiff was not entitled to punitive damages. Post-trial motions are pending.

Broin II Cases

Broin v. Philip Morris, Inc. (Cir. Ct. Miami-Dade County, Fla., filed 1991), was a class action brought on behalf of flight attendants alleged to have suffered from diseases or ailments caused by exposure to ETS in airplane cabins. In October 1997, RJR Tobacco Company, Lorillard Tobacco, B&W and other cigarette manufacturer defendants settled *Broin*, agreeing to pay a total of $300 million in three annual $100 million installments, allocated among the companies by market share, to fund research on the early detection and cure of diseases associated with tobacco smoke. It also required those companies to pay a total of $49 million for the plaintiffs' counsel's fees and expenses. RJR Tobacco Company's portion of these payments was approximately $86 million; Lorillard Tobacco's was approximately $57 million; and B&W's was approximately $31 million. The settlement agreement, among other things, limits the types of claims class members may bring and eliminates claims for punitive damages. The settlement agreement also provides that, in individual cases by class members that are referred to as *Broin II* lawsuits, the defendant will bear the burden of proof with respect to whether ETS can cause certain specifically enumerated diseases, referred to as "general causation." With respect to all other liability issues, including whether an individual plaintiff's disease was caused by his or her exposure to ETS in airplane cabins, referred to as "specific causation," individual plaintiffs will bear the burden of proof. On September 7, 1999, the Florida Supreme Court approved the settlement.

As of June 30, 2017, there were 2,346 *Broin II* lawsuits pending in Florida. There have been no *Broin II* trials since 2007.

Class-Action Suits

Overview

As of June 30, 2017, 25 class-action cases, excluding the shareholder cases described below, were pending in the United States against Reynolds Defendants. These class actions seek recovery for personal injuries allegedly caused by cigarette smoking or, in some cases, for economic damages allegedly incurred by cigarette or e-cigarette purchasers.

In 1996, the Fifth Circuit Court of Appeals in *Castano v. American Tobacco Co.* overturned the certification of a nation-wide class of persons whose claims related to alleged addiction to tobacco products, finding that the district court failed to properly assess variations in the governing state laws and whether common issues predominated over individual issues. Since the Fifth Circuit's ruling in *Castano*, few smoker class-action complaints have been certified or, if certified, have survived on appeal. Eighteen federal courts, including two courts of appeals, and most state courts that have considered the issue have rejected class certification in such cases. Apart from *Castano*, only two smoker class actions have been certified by a federal court — *In re Simon (II) Litigation* and *Schwab [McLaughlin] v. Philip Morris USA Inc.*, both of which were filed in the U.S. District Court for the Eastern District of New York and were later decertified.

Class-action suits based on claims that class members are at a greater risk of injury or injured by the use of tobacco or exposure to ETS, or claims that seek primarily economic damages are pending against RJR Tobacco Company, Lorillard Tobacco, or their affiliates or indemnitees in state or federal courts in California, Florida, Illinois, Louisiana, Missouri, New Mexico, New York, North Carolina and West Virginia. All pending class-action cases are discussed below.

The pending class actions against RJR Tobacco Company or its affiliates or indemnitees include four cases alleging that the use of the term "lights" constitutes unfair and deceptive trade practices under state law or violates federal RICO. Such suits are pending in state courts in Illinois and Missouri and are discussed below under "— *'Lights' Cases*."

E-cigarette class-action cases are pending against RJR Vapor, RAI, and other RAI affiliates in California state and federal courts. In general, the plaintiffs allege that RJR Vapor, Lorillard Tobacco, and other RAI affiliates made false and misleading claims that e-cigarettes are less hazardous than other cigarette products or failed to disclose that e-cigarettes expose users to certain substances. The cases are typically filed pursuant to state consumer protection and related statutes and seek recovery of economic damages and are discussed below under "— *E-Cigarette Cases*."

Several class actions relating to claims in advertising and promotional materials for SFNTC's Natural American Spirit brand cigarettes are pending in federal courts. In general, these plaintiffs allege that use of the

words "natural," "additive-free," or "organic" in Natural American Spirit advertising and promotional materials suggests that those cigarettes are less harmful than other cigarettes and, for that reason, violated state consumer protection statutes or amounted to fraud or a negligent or intentional misrepresentation. These cases are discussed below under "*— No Additive/Natural Claim Cases*."

Additional class actions relating to alleged personal injuries purportedly caused by use of cigarettes or exposure to ETS are pending. These cases are discussed below under "*— Other Class Actions*."

Finally, certain third-party payers have filed health-care cost recovery actions in the form of class actions. These cases are discussed separately below under "*— Health-Care Cost Recovery Cases*."

"Lights" Cases

As noted above, four "lights" class-action cases are pending against RJR Tobacco Company or B&W, two in Illinois state court and two in Missouri state court. The classes in these cases generally seek to recover compensatory and punitive damages, injunctive and other forms of relief, and attorneys' fees and costs from RJR Tobacco Company and/or B&W. In general, the plaintiffs allege that RJR Tobacco Company or B&W made false and misleading claims that "lights" cigarettes were lower in tar and nicotine and/or were less hazardous or less mutagenic than other cigarettes. The cases typically are filed pursuant to state consumer protection and related statutes.

The seminal "lights" class-action case is *Price v. Philip Morris, Inc*. (Cir. Ct. Madison County, Ill., filed 2000), an action filed against the predecessor of Philip Morris USA Inc., referred to as Philip Morris. In March 2003, the trial court entered judgment against Philip Morris in the amount of $7.1 billion in compensatory damages and $3 billion in punitive damages. In December 2005, the Illinois Supreme Court issued an opinion reversing and remanding with instructions to dismiss the case. On December 5, 2006, the Illinois Supreme Court issued its mandate, and the trial court entered a judgment of dismissal later in December 2006. In multiple filings since December 2008, the *Price* plaintiffs have argued that the U.S. Supreme Court's decision in *Good v. Altria Group, Inc*. rejected the basis upon which the Illinois Supreme Court had reversed the *Price* trial court's 2003 judgment and, on that basis, have attempted to reinstate that judgment. In April 2014, the intermediate appellate court reinstated the trial court's 2003 judgment. In November 2015, the Illinois Supreme Court (1) vacated the lower courts' judgments, (2) dismissed the case without prejudice to allow the plaintiffs to file a motion to have the Illinois Supreme Court recall its December 5, 2006, mandate that had reversed the trial court's 2003 judgment, and (3) directed entry of a judgment of dismissal. The plaintiffs then moved in the Illinois Supreme Court to have that court recall its December 5, 2006 mandate. On January 11, 2016, the Illinois Supreme Court denied the plaintiffs' motion. The plaintiffs filed a petition for writ of certiorari with the U.S. Supreme Court on January 22, 2016, which was denied on June 20, 2016.

In *Turner v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Madison County, Ill., filed 2000), the trial court certified a class of purchasers of RJR Tobacco Company "lights" cigarettes in November 2001. In November 2003, the Illinois Supreme Court granted RJR Tobacco Company's motion for a stay pending the court's final appeal decision in the *Price* case described above. The stay subsequently expired, and the court accordingly scheduled a series of status conferences, all of which were continued by agreement of the parties. The status conference scheduled for March 29, 2017 did not occur and has not been rescheduled.

In *Howard v. Brown & Williamson Tobacco Corp.* (Cir. Ct. Madison County, Ill., filed 2000), the trial court certified a class of purchasers of B&W "lights" cigarettes in December 2001. In June 2003, the trial judge issued an order staying all proceedings pending resolution of the *Price* case described above. In August 2005, the Illinois Fifth District Court of Appeals affirmed the Circuit Court's stay order. There is currently no activity in the case.

In *Collora v. R. J. Reynolds Tobacco Co.* (Cir. Ct. City of St. Louis, Mo., filed 2000), the trial court certified a class of purchasers of RJR Tobacco Company "lights" cigarettes in December 2003. A status conference is scheduled for January 8, 2018.

In *Black v. Brown & Williamson Tobacco Corp.* (Cir. Ct. City of St. Louis, Mo., filed 2000), a putative class action filed on behalf of a class of purchasers of B&W "lights" cigarettes, a status conference is scheduled for January 8, 2018.

In the event RJR Tobacco Company and its affiliates or indemnitees lose one or more of the pending "lights" class-action suits, RJR Tobacco Company, depending upon the amount of any damages ordered, could face difficulties in its ability to pay the judgment or obtain any bond required to stay execution of the judgment which could have a material adverse effect on RJR Tobacco Company's, and consequently RAI's, results of operations, cash flows or financial position.

E-Cigarette Cases

In *In re Fontem US, Inc. Consumer Class Action Litig.* (U.S.D.C. C.D. Cal., filed 2015), the plaintiffs brought a class action against RAI, Lorillard, another RAI affiliate, and two other defendants on behalf of putative classes of California, New York, and Illinois purchasers of blu brand e-cigarettes. This action results from the consolidation of two actions — *Diek v. Lorillard Tobacco Co.* and *Whitney v. ITG Brands, LLC.* The plaintiffs allege that certain advertising, marketing and packaging materials for blu brand e-cigarettes made deceptive claims, omitted material information, or failed to contain required disclosures. On behalf of one or more of the classes, the plaintiffs seek injunctive relief, equitable relief, and compensatory and punitive damages under California Civil Code §1,750 *et seq*., California Business & Professions Code §17,200 *et seq*., California Business and Professions Code §17,500 *et seq*., New York General Business Law § 349, and Illinois Consumer Fraud And Deceptive Business Practices Act § 505/1 *et seq.* Pursuant to the terms of the asset purchase agreement relating to the Lorillard Divestiture, RAI tendered the defense of the now-consolidated *Diek* and *Whitney* actions to, and sought indemnification for those actions from, ITG. Pursuant to the terms, limitations and conditions of the asset purchase agreement relating to the Lorillard Divestiture, ITG agreed to defend and indemnify RAI and its affiliates against losses arising from the operation of the blu brand e-cigarette business. On May 20, 2016, the trial court stayed the matter pending the Ninth Circuit Court of Appeals' rulings in *Briseno v. ConAgra Foods, Inc.* (decided January 3, 2017), *Jones v. ConAgra Foods, Inc.* (pending), and *Brazil v. Dole Packaged Foods, LLC* (decided September 30, 2016). The stay did not apply to finalizing the pleadings and related briefing. On May 23, 2016, the plaintiffs filed a second amended consolidated complaint, which the defendants moved to dismiss. On November 1, 2016, the trial court granted the defendants' motion to dismiss in substantial part, finding that federal law preempted all of the plaintiffs' claims except those based on alleged violations of California's Proposition 65 under California's Business and Professions Code §17,200 *et seq*. On March 8, 2017, the trial court denied the plaintiffs' motion to reconsider the November 1, 2016 order and certify that order for interlocutory appeal and ordered the defendants to respond to the second amended complaint. On April 21, 2017, the parties filed a joint stipulation dismissing RAI and related entities from the action.

In *Harris v. R. J. Reynolds Vapor Co.* (U.S.D.C. N.D. Cal., filed 2015), the plaintiff brought a class action against RJR Vapor on behalf of a putative class of purchasers of VUSE e-cigarettes. The plaintiff alleges that RJR Vapor failed to advise users that they potentially could be exposed to formaldehyde and acetaldehyde. The plaintiff asserts failure to warn claims under California's Proposition 65, as well as California Business & Professions Code § 17,200 *et seq.* and California Civil Code § 1,750 *et seq.* and seeks declaratory relief, restitution, disgorgement, injunctive relief and damages. RJR Vapor moved to dismiss contending, among other things, that plaintiff's action was governed in its entirety by Proposition 65 and that the plaintiff failed to give the 60-day pre-suit notice required by Proposition 65, requiring that the entire case be dismissed with prejudice. The motion to dismiss was argued on March 2, 2016. On September 30, 2016, the court granted RJR Vapor's motion to dismiss but provided the plaintiff leave to amend. The plaintiff filed a second amended complaint on October 31, 2016, and RJR Vapor has again moved to dismiss. Oral argument occurred on January 19, 2017. A decision is pending.

No Additive/Natural/Organic Claim Cases

Following the FDA's August 27, 2015, warning letter to SFNTC relating to the use of the words "natural" and "additive-free" in the labeling, advertising and promotional materials for Natural American Spirit brand cigarettes, plaintiffs purporting to bring claims on behalf of themselves and others have filed putative nationwide and/or state-specific class actions against SFNTC and, in some instances, RAI. A total of 16 such actions have been filed in nine U.S. district courts. Each of these cases is discussed below. In various combinations, plaintiffs in these cases generally allege violations of state deceptive and unfair trade practice statutes, and claim state common law fraud, negligent misrepresentation, and unjust enrichment based on the use of descriptors such as "natural," "organic" and "100% additive-free" in the marketing, labeling, advertising, and promotion of SFNTC's Natural American Spirit brand cigarettes. The actions seek various categories of recovery, including economic damages, injunctive relief (including medical monitoring and cessation programs), interest, restitution, disgorgement, treble and punitive damages, and attorneys' fees and costs.

On January 6, 2016, the plaintiffs in one action filed a motion before the U.S. Judicial Panel on Multidistrict Litigation ("JPML") to consolidate these actions before one district court for pretrial purposes. On April 11, 2016, the JPML ordered that these cases be consolidated for pretrial purposes before Judge James O. Browning in the U.S. District Court for the District of New Mexico, referred to as the transferee court, and the then-pending and later-filed cases now are consolidated for pretrial purposes in that court. The cases that were filed in or transferred for pretrial purposes to the transferee court are as follows:

- *Sproule v. Santa Fe Natural Tobacco Co., Inc*. (U.S.D.C. S.D. Fla., filed 2015), is an action against SFNTC and RAI on behalf of a putative nationwide class of purchasers of NATURAL AMERICAN SPIRIT brand cigarettes.
- *Brattain v. Santa Fe Natural Tobacco Co., Inc.* (U.S.D.C. N.D. Cal., filed 2015), is an action against SFNTC and RAI on behalf of a putative class of California purchasers of NATURAL AMERICAN SPIRIT brand cigarettes.
- *Rothman v. Santa Fe Natural Tobacco Co., Inc.* (U.S.D.C. S.D.N.Y., filed 2015), is an action against SFNTC and RAI on behalf of a putative class of New York purchasers of Natural American Spirit brand cigarettes.
- *Dunn v. Santa Fe Natural Tobacco Co., Inc.* (U.S.D.C. D.N.M., filed 2015), is an action against SFNTC on behalf of a putative nationwide class (and Minnesota subclass) of purchasers of Natural American Spirit brand cigarettes.
- *Haksal v. Santa Fe Natural Tobacco Co., Inc.* (U.S.D.C. D.N.M., filed 2015), is an action against SFNTC and RAI on behalf of a putative nationwide class (and California, Illinois, Minnesota, and New Mexico subclasses) of purchasers of Natural American Spirit brand cigarettes.
- *Cuebas v. Santa Fe Natural Tobacco Co., Inc.* (U.S.D.C. S.D.N.Y., filed 2016), is an action against SFNTC and RAI on behalf of a putative nationwide class (and New York subclass) of purchasers of Natural American Spirit brand cigarettes.
- *Okstad v. Santa Fe Natural Tobacco Co., Inc.* (U.S.D.C. M.D. Fla., filed 2016), is an action against SFNTC and RAI on behalf of a putative nationwide class and sixteen putative state-based subclasses (Alabama, California, Colorado, Florida, Georgia, Iowa, Illinois, Maryland, Maine, North Carolina, New Jersey, Ohio, Oregon, Pennsylvania, Texas and Wisconsin subclasses) of purchasers of Natural American Spirit brand cigarettes.
- *Ruggiero v. Santa Fe Natural Tobacco Co., Inc.* (U.S.D.C. D.D.C., filed 2016), is an action against SFNTC and RAI on behalf of a putative nationwide class (and Maryland subclass) of purchasers of Natural American Spirit brand cigarettes.
- *Waldo v. Santa Fe Natural Tobacco Co., Inc.* (U.S.D.C. M.D. Fla., filed 2016), is an action against SFNTC and RAI on behalf of a putative nationwide class (and Florida subclass) of purchasers of Natural American Spirit brand cigarettes.
- *Grandison v. Santa Fe Natural Tobacco Co., Inc.* (U.S.D.C. E.D.N.Y., filed 2016), is an action against SFNTC and RAI on behalf of a putative nationwide class (and California, Florida and New York subclasses) of purchasers of Natural American Spirit brand cigarettes.
- *Gudmundson v. Santa Fe Natural Tobacco Co., Inc.* (U.S.D.C. V.I., filed 2016), is an action against SFNTC and RAI on behalf of a putative class of U.S. Virgin Islands purchasers of Natural American Spirit brand cigarettes.
- *LeCompte v. Santa Fe Natural Tobacco Co., Inc.* (U.S.D.C. D.N.M., filed 2016), is an action against SFNTC and RAI on behalf of a putative class of California purchasers of Natural American Spirit brand cigarettes.
- *White v. Santa Fe Natural Tobacco Co., Inc.* (U.S.D.C. D.N.M., filed 2016), is an action against SFNTC on behalf of a putative nationwide class of purchasers of Natural American Spirit brand cigarettes.
- *Johnston v. Santa Fe Natural Tobacco Co., Inc.* (U.S.D.C. S.D Fla., filed 2016), is an action against SFNTC and RAI on behalf of a putative nationwide class (and Florida subclass) of purchasers of Natural American Spirit brand cigarettes.
- *Cole v. Santa Fe Natural Tobacco Co., Inc.* (U.S.D.C. M.D. N.C., filed 2016), is an action against SFNTC and RAI on behalf of a putative nationwide class (and North Carolina subclass) of purchasers of Natural American Spirit brand cigarettes.

- *Hebert v. Santa Fe Natural Tobacco Co., Inc.* (U.S.D.C. M.D. N.C., filed 2016), is an action against SFNTC, RAI and RJR Tobacco Company on behalf of a putative class of purchasers in California, Colorado, Florida, Illinois, Massachusetts, Michigan, New Jersey, New Mexico, New York, Ohio and Washington of Natural American Spirit cigarettes, and a nationwide putative class of Natural American Spirit brand menthol cigarette purchasers (and subclass of such purchasers in California, Colorado, Florida, Illinois and New Mexico).

The transferee court entered a scheduling order requiring the plaintiffs to file a consolidated amended complaint. On September 19, 2016, the plaintiffs filed a consolidated amended complaint naming SFNTC, RAI, and RJR Tobacco Company as defendants. That complaint alleges violations of 12 states' deceptive and unfair trade practices statutes — California, Colorado, Florida, Illinois, Massachusetts, Michigan, North Carolina, New Jersey, New Mexico, New York, Ohio, and West Virginia — based on the use of descriptors such as "natural," "organic" and "100% additive-free" in the marketing, labeling, advertising, and promotion of SFNTC's Natural American Spirit brand cigarettes. It also asserts unjust enrichment claims under those 12 states' laws and asserts breach of express warranty claims on behalf of a national class of Natural American Spirit menthol purchasers. The state deceptive and unfair trade practice statutory and unjust enrichment claims are brought on behalf of state-specific classes in the 12 states listed above and, in some instances, state-specific subclasses. The consolidated amended complaint seeks class certification, payment for class notice, injunctive relief, monetary damages, prejudgment interest, statutory damages, restitution, and attorneys' fees and costs. On November 18, 2016, the defendants filed a motion to dismiss. Before responding to the motion to dismiss, the plaintiffs filed a second amended class action complaint on January 12, 2017. On February 23, 2017, the defendants moved to dismiss the second amended complaint. Oral argument on the defendants' motion to dismiss commenced on June 9, 2017 and is now completed. A decision is pending. The transferee court's scheduling order, as amended, provides for the plaintiffs to file a motion for class certification by April 3, 2018, and a hearing on the class certification motion on July 13-14, 2018.

On November 7, 2016, a public health advocacy organization filed *Breathe DC v. Santa Fe Natural Tobacco Co., Inc*. (D.C. Super. Ct.), an action against SFNTC, RAI and RJR Tobacco Company based on allegations relating to the labeling, advertising and promotional materials for Natural American Spirit brand cigarettes that are similar to the allegations in the actions consolidated for pre-trial purposes in the transferee court described immediately above. The complaint seeks injunctive and other non-monetary relief, but does not seek monetary damages. On December 6, 2016, the defendants removed the action to the U.S. District Court for the District of Columbia and, on December 7, 2016, filed a notice with the JPML to have the action transferred to the transferee court. On December 7, 2016, the plaintiff moved in the U.S. District Court for the District of Columbia to remand the action to the Superior Court for the District of Columbia. On February 14, 2017, the U.S. District Court for the District of Columbia granted the plaintiffs' motion to remand, and the case was remanded to the Superior Court of the District of Columbia. On June 9, 2017, the defendants moved to dismiss, and the court entered an order providing for briefing on that motion to conclude by August 29, 2017.

Other Class Actions

In *Young v. American Tobacco Co., Inc.* (Cir. Ct. Orleans Parish, La., filed 1997), the plaintiff brought a class action against U.S. cigarette manufacturers, including RJR Tobacco Company and B&W, and parent companies of U.S. cigarette manufacturers, including R.J. Reynolds Tobacco Holdings, Inc., on behalf of a putative class of Louisiana residents who, though not themselves cigarette smokers, allegedly suffered injury as a result of exposure to ETS from cigarettes manufactured by defendants. The plaintiffs seek to recover an unspecified amount of compensatory and punitive damages. In March 2016, the court entered an order staying the case, including all discovery, pending the completion of the smoking cessation program ordered by the court in *Scott v. The American Tobacco Co*.

In *Parsons v. A C & S, Inc.* (Cir. Ct. Ohio County, W. Va., filed 1998), the plaintiff brought a class action against asbestos manufacturers, U.S. cigarette manufacturers, including RJR Tobacco Company, B&W, Lorillard Tobacco, and parent companies of U.S. cigarette manufacturers, including R.J. Reynolds Tobacco Holdings, Inc. and Lorillard, on behalf of a putative class of persons who allegedly have personal injury claims arising from their exposure to respirable asbestos fibers and cigarette smoke. The plaintiff seeks to recover $1 million in compensatory and punitive damages individually for her purported injuries and an unspecified amount for the class in compensatory and punitive damages. In December 2000, three defendants, Nitral Liquidators, Inc., Desseaux Corporation of North America and Armstrong World Industries, filed bankruptcy petitions in the U.S. Bankruptcy Court for the District of Delaware, *In re Armstrong World Industries, Inc.* Pursuant to section 362(a) of the Bankruptcy Code, *Parsons* is automatically stayed with respect to all defendants who filed for bankruptcy. The case remains pending against the other defendants, including RJR Tobacco Company and Lorillard Tobacco, but it has long been dormant.

In *Jones v. American Tobacco Co., Inc.* (Cir. Ct., Jackson County, Mo., filed 1998), the plaintiff filed a class action against the major U.S. cigarette manufacturers, including RJR Tobacco Company, B&W, Lorillard Tobacco, and parent companies of U.S. cigarette manufacturers, including R.J. Reynolds Tobacco Holdings, Inc. and Lorillard, on behalf of a putative class of Missouri tobacco product users and purchasers who allegedly became addicted to nicotine. The plaintiffs seek an unspecified amount of compensatory and punitive damages. There is currently no activity in this case.

Filter Cases

Claims have been brought against Lorillard Tobacco and Lorillard by individuals who seek damages resulting from their alleged exposure to asbestos fibers that were incorporated into filter material used in one brand of cigarettes manufactured by a predecessor to Lorillard Tobacco for a limited period of time ending more than 50 years ago. As of June 30, 2017, Lorillard Tobacco and/or Lorillard was a defendant in 73 Filter Cases. Since January 1, 2014, Lorillard Tobacco and RJR Tobacco Company have paid, or have reached agreement to pay, a total of approximately $42.3 million in settlements to resolve 165 Filter Cases.

Pursuant to the terms of a 1952 agreement between P. Lorillard Company and H&V Specialties Co., Inc. (the manufacturer of the filter material), Lorillard Tobacco is required to indemnify Hollingsworth & Vose for legal fees, expenses, judgments and resolutions in cases and claims alleging injury from finished products sold by P. Lorillard Company that contained the filter material.

On September 13, 2013, the jury in a Filter Case, *DeLisle v. A. W. Chesterton Co.* (Cir. Ct. Broward County, Fla., filed 2012), found for the plaintiffs on the negligence and strict liability claims; awarded the plaintiffs $8 million in compensatory damages; and found Lorillard Tobacco 22% at fault, Hollingsworth & Vose 22% at fault, and the other defendants 56% at fault. Punitive damages were not at issue. On November 6, 2013, the trial court entered final judgment against Lorillard Tobacco in the amount of $3.52 million. Lorillard Tobacco appealed to the Fourth DCA. On September 14, 2016, the Fourth DCA ordered a new trial because the trial court erred in admitting certain expert testimony and concluded that the $8 million compensatory damages award should have been remitted. On July 7, 2017, the Florida Supreme Court granted the plaintiff's motion and stayed proceedings in the Fourth DCA and in the trial court, pending disposition of the petition for discretionary review, and it accepted jurisdiction and granted review on July 11, 2017. Oral argument has not been scheduled.

Health-Care Cost Recovery Cases

Health-care cost recovery cases have been brought by a variety of plaintiffs. Other than certain governmental actions, these cases largely have been unsuccessful on remoteness grounds, which means that one who pays an injured person's medical expenses is legally too remote to maintain an action against the person allegedly responsible for the injury.

As of June 30, 2017, two health-care cost recovery cases were pending in the United States against RJR Tobacco Company, B&W, Lorillard Tobacco, or all three, as discussed below after the discussion of the State Settlement Agreements. A limited number of claimants have filed suit against RJR Tobacco Company, one of its affiliates, and other tobacco industry defendants to recover funds for health care, medical and other assistance paid by foreign provincial governments in treating their citizens. For additional information on these cases, see "*— International Cases*" below.

State Settlement Agreements. In June 1994, the Mississippi Attorney General brought an action, *Moore v. American Tobacco Co.*, against various industry members, including RJR Tobacco Company, B&W and Lorillard Tobacco. This case was brought on behalf of the state to recover state funds paid for health care and other assistance to state citizens suffering from diseases and conditions allegedly related to tobacco use. Most other states, through their attorneys general or other state agencies, sued RJR Tobacco Company, B&W, Lorillard Tobacco and other U.S. cigarette manufacturers based on similar theories. The cigarette manufacturer defendants, including RJR Tobacco Company, B&W and Lorillard Tobacco, settled the first four of these cases scheduled for trial — Mississippi, Florida, Texas and Minnesota — by separate agreements with each such state.

On November 23, 1998, the major U.S. cigarette manufacturers, including RJR Tobacco Company, B&W and Lorillard Tobacco, entered into the Master Settlement Agreement with attorneys general representing the remaining 46 states, the District of Columbia, Puerto Rico, Guam, the Virgin Islands, American Samoa and the Northern Marianas. Effective on November 12, 1999, the MSA settled all the health-care cost recovery actions brought by, or on behalf of, the settling jurisdictions and released various additional present and future claims.

In the settling jurisdictions, the MSA released RJR Tobacco Company, B&W, Lorillard Tobacco, and their affiliates and indemnitees, including RAI and Lorillard, from:

- all claims of the settling states and their respective political subdivisions and other recipients of state health-care funds, relating to past conduct arising out of the use, sale, distribution, manufacture,

development, advertising, marketing or health effects of, the exposure to, or research, statements or warnings about, tobacco products; and

- all monetary claims of the settling states and their respective political subdivisions and other recipients of state health-care funds, relating to future conduct arising out of the use of or exposure to, tobacco products that have been manufactured in the ordinary course of business.

Set forth below is the unadjusted tobacco industry settlement payment schedule (in millions) for 2015 and thereafter:

	2015 and thereafter
First Four States' Settlements:[1]	
Mississippi Annual Payment	$ 136
Florida Annual Payment	440
Texas Annual Payment	580
Minnesota Annual Payment	204
Master Settlement Agreement:	
Annual Payments[1]	8,004
Total	$9,364

RAI's operating subsidiaries expenses and payments under the State Settlement Agreements for 2015, 2016 and the projected expenses and payments for 2017 and thereafter (in millions) are set forth below.[1][2]

	2015	**2016**	**2017**	**2018 and thereafter**
Settlement expenses	$2,403	$2,727	—	—
Settlement cash payments	$2,166	$3,042	—	—
Projected settlement expenses			$>3,000	$>3,000
Projected settlement cash payments			$>2,700	$>3,000

[1] Subject to adjustments for changes in sales volume, inflation, operating profit and other factors. Payments are allocated among the companies on the basis of relative market share or other methods. For further information, see "— *State Settlement Agreements — Enforcement and Validity; Adjustments*" below.

[2] The amounts above reflect the impact of the Term Sheet and the NY State Settlement described below under "— *State Settlement Agreements — Enforcement and Validity; Adjustments — Partial Settlement of Certain NPM Adjustment Claims*."

The State Settlement Agreements also contain provisions restricting the marketing of tobacco products. Among these provisions are restrictions or prohibitions on the use of cartoon characters, brand-name sponsorships, apparel and other merchandise, outdoor and transit advertising, payments for product placement, free sampling and lobbying. Furthermore, the State Settlement Agreements required the dissolution of three industry-sponsored research and trade organizations.

The State Settlement Agreements have materially adversely affected RJR Tobacco Company's shipment volumes. RAI believes that these settlement obligations may materially adversely affect the results of operations, cash flows or financial position of RAI and RJR Tobacco Company in future periods. The degree of the adverse impact will depend, among other things, on the rate of decline in U.S. cigarette sales in the premium and value categories, RJR Tobacco Company's share of the domestic premium and value cigarette categories, and the effect of any resulting cost advantage of manufacturers not subject to the State Settlement Agreements.

U.S. Department of Justice Case

In *United States v. Philip Morris USA Inc.* (U.S.D.C. D.D.C., filed 1999), the U.S. Department of Justice brought an action against RJR Tobacco Company, B&W, Lorillard Tobacco and other tobacco companies seeking (1) recovery of federal funds expended in providing health care to smokers who developed alleged smoking-related diseases pursuant to the Medical Care Recovery Act and Medicare Secondary Payer provisions of the Social Security Act and (2) equitable relief under the civil provisions of RICO, including disgorgement of roughly $280 billion in profits the government contended were earned as a consequence of a purported racketeering "enterprise." In September 2000, the district court dismissed the government's Medical Care Recovery Act and Medicare Secondary Payer claims. In February 2005, the U.S. Court of Appeals for the D.C. Circuit, referred to as the D.C. Circuit, ruled that disgorgement was not an available remedy.

On August 17, 2006, after a non-jury bench trial, the district court found certain defendants, including RJR Tobacco Company, B&W and Lorillard Tobacco, had violated RICO, but did not impose any direct financial penalties. The district court instead enjoined RJR Tobacco Company, Lorillard Tobacco and the other defendants

from committing future racketeering acts, participating in certain trade organizations, making misrepresentations concerning smoking and health and youth marketing, and using certain brand descriptors such as "low tar," "light," "ultra light," "mild" and "natural." The district court also ordered RJR Tobacco Company, Lorillard Tobacco and the other defendants to issue "corrective communications" on five subjects, including smoking and health and addiction, and to comply with further undertakings, including maintaining web sites of historical corporate documents and disseminating certain marketing information on a confidential basis to the government. In addition, the district court placed restrictions on the defendants' ability to dispose of certain assets for use in the United States, unless the transferee agrees to abide by the terms of the district court's order, and ordered certain defendants to reimburse the U.S. Department of Justice its taxable costs incurred in connection with the case.

Defendants, including RJR Tobacco Company, B&W, and Lorillard Tobacco, appealed, the government cross appealed, and the defendants moved in the district court for clarification and a stay pending appeal. After the district court denied the defendants' motion to stay, the D.C. Circuit granted a stay in October 2006.

The district court then granted the motion for clarification in part and denied it in part. With respect to the meaning and applicability of the general injunctive relief of the August 2006 order, the district court denied the motion for clarification. With respect to the request for clarification as to the scope of the provisions in the order prohibiting the use of descriptors and requiring corrective statements at retail point of sale, the district court granted the motion and also ruled that the provisions prohibiting the use of express or implied health messages or descriptors do apply to the actions of the defendants taken outside of the United States.

In May 2009, the D.C. Circuit largely affirmed both the finding of liability against the tobacco defendants and the remedial order, including the denial of additional remedies, but vacated the order and remanded for further proceedings as to the following four discrete issues:

- the issue of the extent of B&W's control over tobacco operations was remanded for further fact finding and clarification;
- the remedial order was vacated to the extent that it binds all defendants' subsidiaries and was remanded to the district court for determination as to whether inclusion of the subsidiaries and which of the subsidiaries satisfy Rule 65(d) of the Federal Rules of Civil Procedure;
- the D.C. Circuit held that the provision found in paragraph four of the injunction, concerning the use of any express or implied health message or health descriptor for any cigarette brand, should not be read to govern overseas sales. The issue was remanded to the district court with instructions to reformulate it so as to exempt foreign activities that have no substantial, direct and foreseeable domestic effects; and
- the remedial order was vacated regarding "point of sale" displays and remanded for the district court to evaluate and make due provisions for the rights of innocent persons, either by abandoning this part of the remedial order or re-crafting a new version reflecting the rights of third parties.

In June 2010, the U.S. Supreme Court denied all parties' petitions for writ of certiorari.

Post-remand proceedings are underway. On December 22, 2010, the district court dismissed B&W from the litigation. In November 2012, the trial court entered an order setting forth the text of the corrective statements and directed the parties to engage in discussions with the Special Master to implement them. After extensive mediation led the parties to an implementation agreement, the district court entered an implementation order on June 2, 2014. The defendants filed a consolidated appeal challenging both the content of the court-ordered statements and the requirement that those statements be published in redundant media. On May 22, 2015, the D.C. Circuit reversed the corrective statements order in part, affirmed in part, and remanded to the district court for further proceedings. On October 1, 2015, the district court ordered the parties to propose new corrective-statements preambles. On February 8, 2016, the district court entered an order adopting the government's proposed corrective-statements preamble. The parties then mediated, per the district court's order, changes to the implementation order necessitated by the new preamble. On April 19, 2016, the district court accepted the parties' mediated agreement on implementation and entered a superseding consent order with respect to implementation. The superseding consent order stays implementation of the corrective statements until the exhaustion of appeals from the orders establishing the text of those statements and governing implementation details. On April 7, 2016, the defendants and the post-judgment parties regarding remedies noticed an appeal to the D.C. Circuit from the order adopting the government's proposed corrective-statement preambles. On May 6, 2016, the defendants and post-judgment parties regarding remedies noticed an appeal to the D.C. Circuit from the superseding consent order. On June 7, 2016, the D.C. Circuit granted the unopposed motion of the defendants and the post-judgment parties regarding remedies to consolidate the two appeals. Briefing in the consolidated appeals concluded in late December 2016, and oral argument occurred on February 14, 2017. On April 25, 2017,

the D.C. Circuit affirmed in part, reversed in part, and remanded for further proceedings. The court has not yet set a schedule for the proceedings on remand. Additionally, RJR Tobacco Company appealed the district court's May 28, 2015, order requiring RJR Tobacco Company to televise an additional set of corrective statements on behalf of B&W. On November 1, 2016, the D.C. Circuit upheld the order. In light of the corrective-statements implementation requirements, $20 million has been accrued for the estimated costs of the corrective communications and is included in RAI's unaudited condensed consolidated balance sheet as of June 30, 2017, included in this Offering Memorandum.

Native American Tribe Case

As of June 30, 2017, one Native American tribe case was pending before a tribal court against RJR Tobacco Company, B&W and Lorillard Tobacco, *Crow Creek Sioux Tribe v. American Tobacco Co.* (Tribal Ct., Crow Creek Sioux, S.D., filed 1997). The plaintiffs seek to recover actual and punitive damages, restitution, funding of a clinical cessation program, funding of a corrective public education program, and disgorgement of unjust profits from sales to minors. The plaintiffs claim that the defendants are liable under the following theories: unlawful marketing and targeting of minors, contributing to the delinquency of minors, unfair and deceptive acts or practices, unreasonable restraint of trade and unfair method of competition, negligence, negligence per se, conspiracy and restitution of unjust enrichment. The case is dormant.

International Cases

Each of the ten Canadian provinces has filed a health-care cost recovery action against Canadian and non-Canadian tobacco-related entities, including RJR Tobacco Company and one of its affiliates. In these actions, which are described below, each of the Canadian provinces seeks to recover for health care, medical and other assistance paid and to be paid for treating tobacco-related disease. Pursuant to the terms of the 1999 sale of RJR Tobacco Company's international tobacco business, RJR Tobacco Company has tendered the defense of these actions to JTI. Subject to a reservation of rights, JTI has assumed the defense of RJR Tobacco Company and its affiliate in these actions.

- *British Columbia* (British Columbia Sup. Ct., Vancouver Registry, filed 1997) — In 1997, British Columbia enacted a statute creating a civil cause of action against tobacco-related entities for the provincial government to recover the costs of health-care benefits incurred for insured British Columbia residents resulting from tobacco-related disease. An initial action brought pursuant to the statute against Canadian and non-Canadian tobacco-related entities, including RJR Tobacco Company and certain of its affiliates, was dismissed in February 2000 when the British Columbia Supreme Court ruled that the legislation was unconstitutional. British Columbia then enacted a revised statute, pursuant to which an action was filed in January 2001 against many of the same defendants, including RJR Tobacco Company and one of its affiliates. In that action, the British Columbia government seeks to recover the present value of its total expenditures for health-care benefits provided for insured persons resulting from tobacco-related disease or the risk of tobacco-related disease caused by alleged breaches of duty by the manufacturers, the present value of its estimated total expenditures for health-care benefits that reasonably could be expected to be provided for those insured persons resulting from tobacco-related disease or the risk of tobacco-related disease in the future, court ordered interest, and costs, or in the alternative, special or increased costs. The government alleges that the defendants are liable under the British Columbia statute by reason of their "tobacco related wrongs," which are alleged to include: selling defective products, failure to warn, sale of cigarettes to children and adolescents, strict liability, deceit and misrepresentation, violation of trade practice and competition acts, concerted action, and joint liability. RJR Tobacco Company and its affiliate filed statements of defense in January 2007. Pretrial discovery is ongoing.
- *New Brunswick* (Ct. of Queen's Bench of New Brunswick, Jud. Dist. Fredericton, filed 2008) — This claim is brought pursuant to New Brunswick legislation enacted in 2008 that is substantially similar to the revised British Columbia statute described above. It seeks recovery of essentially the same types of damages sought in the British Columbia action based on analogous theories of liability. RJR Tobacco Company and its affiliate filed statements of defense in March 2010. Pretrial discovery is ongoing. Trial has been set to begin on November 4, 2019.
- *Ontario* (Ontario Super. Ct. Justice, Toronto, filed 2009) — This claim is brought pursuant to Ontario legislation that is substantially similar to the revised British Columbia statute described above. It seeks recovery of essentially the same types of damages sought in the British Columbia action based on analogous theories of liability, although the government also asserted claims based on the illegal importation of cigarettes, which claims were deleted in an amended statement of claim filed in August 2010. RJR Tobacco Company and its affiliate filed statements of defense in April 2016.

- *Newfoundland and Labrador* (Sup. Ct. Newfoundland and Labrador, St. John's, filed 2011) — This claim is brought pursuant to Newfoundland and Labrador legislation that is substantially similar to the revised British Columbia statute described above. It seeks recovery of essentially the same types of damages sought in the British Columbia action based on analogous theories of liability. RJR Tobacco Company and its affiliate filed statements of defense in May 2016.
- *Manitoba* (Ct. of Queen's Bench, Winnipeg Jud. Centre, filed 2012) — This claim is brought pursuant to Manitoba legislation that is substantially similar to the revised British Columbia statute described above. It seeks recovery of essentially the same types of damages sought in the British Columbia action based on analogous theories of liability. RJR Tobacco Company and its affiliate filed statements of defense in September 2014. Pre-trial discovery is ongoing.
- *Quebec* (Super. Ct. Quebec, Dist. Montreal, filed 2012) — This claim is brought pursuant to Quebec legislation that is substantially similar to the revised British Columbia statute described above. It seeks recovery of essentially the same types of damages being sought in the British Columbia action based on analogous theories of liability. RJR Tobacco Company and its affiliate filed defenses in December 2014. Pretrial discovery is ongoing.
- *Saskatchewan* (Ct. of Queen's Bench, Jud. Centre Saskatoon, filed 2012) — This claim is brought pursuant to Saskatchewan legislation that is substantially similar to the revised British Columbia statute described above. It seeks recovery of essentially the same types of damages sought in the British Columbia action based on analogous theories of liability. RJR Tobacco Company and its affiliate filed statements of defense in February 2015.
- *Alberta* (Ct. of Queen's Bench, Alberta Jud. Centre of Calgary, filed 2012) — This claim is brought pursuant to Alberta legislation that is substantially similar to the revised British Columbia statute described above. It seeks recovery of essentially the same types of damages sought in the British Columbia action based on analogous theories of liability. RJR Tobacco Company and its affiliate filed statements of defense in March 2016.
- *Prince Edward Island* (Sup. Ct. P.E.I., Charlottetown, filed 2012) — This claim is brought pursuant to Prince Edward Island legislation that is substantially similar to the revised British Columbia statute described above. It seeks recovery of essentially the same types of damages sought in the British Columbia action based on analogous theories of liability. RJR Tobacco Company and its affiliate filed statements of defense in February 2015.
- *Nova Scotia* (Sup. Ct. Nova Scotia, Halifax, filed 2015) — This claim is brought pursuant to Nova Scotia legislation that is substantially similar to the revised British Columbia statute described above. It seeks recovery of essentially the same types of damages sought in the British Columbia action based on analogous theories of liability. RJR Tobacco Company and its affiliate filed statements of defense in July 2015.

Seven putative class actions, which are described below, have been filed against various Canadian and non-Canadian tobacco-related entities, including RJR Tobacco Company and one of its affiliates, in Canadian provincial courts. In these cases, the plaintiffs allege claims based on fraud, fraudulent concealment, breach of warranty, breach of warranty of merchantability, and of fitness for a particular purpose, failure to warn, design defects, negligence, breach of a "special duty" to children and adolescents, conspiracy, concert of action, unjust enrichment, market share liability, and violations of various trade practices and competition statutes. The plaintiffs seek recovery on behalf of proposed classes of persons allegedly suffering from tobacco-related disease as a result of smoking defendants' cigarettes and seek recovery of compensatory and punitive damages, restitution, recovery of government health-care benefits, interest, and costs. Pursuant to the terms of the 1999 sale of RJR Tobacco Company's international tobacco business, RJR Tobacco Company has tendered the defense of these seven actions to JTI. Subject to a reservation of rights, JTI has assumed the defense of RJR Tobacco Company and its current or former affiliates in these actions. Plaintiffs' counsel have been actively pursuing only *Bourassa*, the action pending in British Columbia, at this time.

- In *Kunka v. Canadian Tobacco Manufacturers' Council* (Ct. of Queen's Bench, Winnipeg Jud. Centre, filed 2009), the plaintiff seeks compensatory and punitive damages on behalf of a proposed class of persons who purchased or smoked defendants' cigarettes and suffered, or currently suffer, from tobacco-related disease, as well as restitution of profits and reimbursement of government expenditure for health-care benefits allegedly caused by the use of tobacco products.
- In *Dorion v. Canadian Tobacco Manufacturers' Council* (Ct. of Queen's Bench, Alberta Jud. Centre of Calgary — filed 2009), the plaintiff seeks compensatory and punitive damages on behalf of a proposed

class of persons who purchased or smoked defendants' cigarettes and suffered, or currently suffer, from tobacco-related disease, as well as restitution of profits and reimbursement of government expenditure for health-care benefits allegedly caused by the use of tobacco products.

- In *Semple v. Canadian Tobacco Manufacturers' Council* (Sup. Ct. Nova Scotia, Halifax, filed 2009), the plaintiff seeks compensatory and punitive damages on behalf of a proposed class comprised of persons who purchased or smoked defendants' cigarettes for the period from January 1, 1954, to the expiry of the opt-out period as set by the court and suffered, or currently suffer, from tobacco-related disease, as well as restitution of profits and reimbursement of government expenditure for health-care costs allegedly caused by the use of tobacco products.
- In *Adams v. Canadian Tobacco Manufacturers' Council* (Ct. of Queen's Bench, Jud. Centre of Regina, filed 2009), the plaintiff seeks compensatory and punitive damages on behalf of a proposed class of persons who were alive on July 10, 2009, and suffered, or currently suffer, from chronic obstructive pulmonary disease, emphysema, heart disease or cancer, after having smoked a minimum of 25,000 of defendants' cigarettes, as well as disgorgement of revenues earned by the defendants. RJR Tobacco Company and its affiliate have brought a motion challenging the jurisdiction of the Saskatchewan court.
- In *Bourassa v. Imperial Tobacco Canada Ltd.* (Sup. Ct. of British Columbia, Victoria Registry, filed 2010), the plaintiff seeks compensatory and punitive damages on behalf of a proposed class of persons who were alive on June 12, 2007, and suffered, or currently suffer, from chronic respiratory diseases, after having smoked a minimum of 25,000 of defendants' cigarettes, as well as disgorgement of revenues earned by the defendants from January 1, 1954, to the date the claim was filed. RJR Tobacco Company and its affiliate have filed a challenge to the jurisdiction of the British Columbia court. The plaintiff filed a motion for certification in April 2012, and filed affidavits in support in August 2013. An amended claim was filed in December 2014.
- In *McDermid v. Imperial Tobacco Canada Ltd.* (Sup. Ct. of British Columbia, Victoria Registry, filed 2010), the plaintiff seeks compensatory and punitive damages on behalf of a proposed class of persons who were alive on June 12, 2007, and suffered, or currently suffer, from heart disease, after having smoked a minimum of 25,000 of defendants' cigarettes, as well as disgorgement of revenues earned by the defendants from January 1, 1954, to the date the claim was filed. RJR Tobacco Company and its affiliate have filed a challenge to the jurisdiction of the British Columbia court.
- In *Jacklin v. Canadian Tobacco Manufacturers' Council* (Ontario Super. Ct. of Justice, St. Catherines, filed 2012), the plaintiff seeks compensatory and punitive damages on behalf of a proposed class of persons who were alive on June 12, 2007, and suffered, or currently suffer, from chronic obstructive pulmonary disease, heart disease, or cancer, after having smoked a minimum of 25,000 of defendants' cigarettes, as well as restitution of profits, and reimbursement of government expenditure for health-care benefits allegedly caused by the use of tobacco products.

State Settlement Agreements — Enforcement and Validity; Adjustments

As of June 30, 2017, there were two cases concerning the enforcement, validity or interpretation of the State Settlement Agreements in which RJR Tobacco Company, B&W or Lorillard Tobacco is a party. This number includes the motion to enforce, discussed below, relating to disputed payments under the State Settlement Agreements.

In May 2006, the State of Florida filed a motion, in the Circuit Court of the Fifteenth Judicial Circuit, in and for Palm Beach County, Florida, to enforce the Florida settlement agreement, referred to as the Florida Settlement Agreement, for an accounting by B&W and for an Order of Contempt. The State asserted that B&W failed to report in its net operating profit on its shipments, cigarettes manufactured by B&W under contract for Star Tobacco or its parent, Star Scientific, Inc. The State is seeking approximately $12.4 million in additional payments under the Florida Settlement Agreement, as well as $17.0 million in interest payments. This matter is currently in the discovery phase.

On January 18, 2017, the State of Florida filed a motion to enjoin ITG as a defendant and to enforce the Florida Settlement Agreement. The State's motion seeks payment under the Florida Settlement Agreement with respect to the four brands (Winston, Salem, Kool and Maverick) that were sold to ITG in the Lorillard Divestiture. Under the asset purchase agreement relating to the Lorillard Divestiture (and related documents), ITG was to assume responsibility with respect to these brands. Since the closing of the Lorillard Divestiture and the transfer of these brands to it, ITG has not made settlement payments to the State with respect to these brands. The State's motion asserts that it "is presently owed more than $45 million and will continue to suffer annual

losses of approximately $30 million absent the Court's enforcement of the Settlement Agreement…." The State's motion seeks, among other things, an order from the court declaring that RJR Tobacco Company and ITG are in breach of the Florida Settlement Agreement and are required, jointly and severally, to make annual payments to the State under the Florida Settlement Agreement with respect to the brands transferred to ITG in the Lorillard Divestiture.

Also on January 18, 2017, Philip Morris USA, Inc. filed a motion to enforce the Florida Settlement Agreement. Philip Morris USA, Inc.'s motion asserted that RJR Tobacco Company and ITG have breached the Florida Settlement Agreement by failing to comply with the obligations under the Florida Settlement Agreement with respect to the transferred brands. Philip Morris USA, Inc.'s motion asserts that RJR Tobacco Company and ITG have "…deprived the State…of over $40 million in settlement payments and improperly shifted millions of the remaining settlement payment obligations from themselves to Philip Morris USA, Inc., amounts that will increase greatly going forward absent intervention by [the] Court." Philip Morris USA, Inc.'s motion seeks various forms of relief to modify the settlement payment calculations to address the issues raised in its motion.

On January 27, 2017, RJR Tobacco Company filed a motion asserting that ITG failed to use its reasonable best efforts to join the Florida Settlement Agreement and breached the asset purchase agreement relating to the Lorillard Divestiture. Accordingly, RJR Tobacco Company filed a motion for leave to allow a supplemental pleading for breach by ITG of its obligations regarding joinder into the Florida Settlement Agreement. On March 30, 2017, the Florida court ruled that ITG should be joined into the enforcement action. Discovery related to the various motions is now underway. Court-ordered mediation occurred on July 17, 2017, and the parties did not reach a resolution.

On February 17, 2017, ITG filed a complaint in the Court of Chancery of the State of Delaware seeking declaratory relief and a motion for a temporary restraining order against RAI and RJR Tobacco Company. In its complaint, ITG asked the court to declare various matters related to its rights and obligations under the asset purchase agreement (and related documents). In its motion, ITG asked for an injunction barring RAI and/or RJR Tobacco Company from alleging in the Florida enforcement litigation that ITG had breached the asset purchase agreement and requiring these companies to litigate issues under the asset purchase agreement in Delaware. A hearing was held on ITG's complaint and motion on March 1, 2017. After argument, the court entered a temporary restraining order that enjoined RAI and RJR Tobacco Company from "taking offensive action to assert claims against ITG Brands" in the Florida enforcement action, but the order does not prevent RJR Tobacco Company from making arguments in response to claims asserted by the State of Florida, Philip Morris USA, Inc. or ITG in the Florida enforcement litigation. On March 24, 2017, RAI and RJR Tobacco Company answered the ITG complaint and filed a motion to stay proceedings in Delaware pending the outcome of the Florida enforcement litigation. The motion for stay filed by RAI and RJR Tobacco Company was denied on May 18, 2017. Cross motions for partial judgment on the pleadings were filed focusing on whether ITG's obligation to use "reasonable best efforts" to join the Florida Settlement continued after the June 12, 2015 closing. Briefing is in progress, and oral argument on the cross motions has been scheduled for September 8, 2017.

NPM Adjustment Claims

The MSA includes an adjustment that potentially reduces the annual payment obligations of RJR Tobacco Company, Lorillard Tobacco and the other PMs. Certain requirements, collectively referred to as the Adjustment Requirements, must be satisfied before the NPM Adjustment for a given year is available:

- an Independent Auditor must determine that the PMs have experienced a market share loss, beyond a triggering threshold, to those manufacturers that do not participate in the MSA, such non-participating manufacturers referred to as NPMs; and
- in a binding arbitration proceeding, a firm of independent economic consultants must find that the disadvantages of the MSA were a significant factor contributing to the loss of market share. This finding is known as a significant factor determination.

When the Adjustment Requirements are satisfied, the MSA provides that the NPM Adjustment applies to reduce the annual payment obligation of the PMs. However, an individual settling state may avoid its share of the NPM Adjustment if it had in place and diligently enforced during the entirety of the relevant year a "Qualifying Statute" that imposes escrow obligations on NPMs that are comparable to what the NPMs would have owed if they had joined the MSA. In such event, the state's share of the NPM Adjustment is reallocated to other settling states, if any, that did not have in place and diligently enforce a Qualifying Statute.

NPM Adjustment Claim for 2003

For 2003, the Adjustment Requirements were satisfied. As a result, based on revised numbers calculated by the Independent Auditor, RJR Tobacco Company placed approximately $615 million, and Lorillard Tobacco

placed approximately $109 million, of its 2006 and 2007 MSA payments into a disputed payments account, in accordance with a procedure established by the MSA.

As a result of this action, 37 of the settling states filed legal proceedings in their respective MSA courts seeking declaratory orders that they diligently enforced their Qualifying Statutes during 2003 and/or orders compelling RJR Tobacco Company and the other PMs that placed money in the disputed payments account to pay the disputed amounts to the settling states. In response, RJR Tobacco Company and other PMs, pursuant to the MSA's arbitration provisions, moved to compel arbitration of the parties' dispute concerning the 2003 NPM Adjustment, including the states' diligent enforcement claims, before an arbitration panel consisting of three retired federal court judges. The settling states opposed these motions, arguing, among other things, that the issue of diligent enforcement must be resolved by MSA courts in each of the 52 settling states and territories.

Forty-seven of the 48 courts that addressed the question whether the dispute concerning the 2003 NPM Adjustment is arbitrable ruled that arbitration was required under the MSA. The Montana Supreme Court ruled that the State of Montana did not agree to arbitrate the question of whether it diligently enforced a Qualifying Statute. Subsequently, Montana and the PMs reached an agreement whereby the PMs agreed not to contest Montana's claim that it diligently enforced the Qualifying Statute during 2003.

In January 2009, RJR Tobacco Company and certain other PMs entered into an Agreement Regarding Arbitration, referred to as the Arbitration Agreement, with 45 of the MSA settling states (representing approximately 90% of the allocable share of the settling states) pursuant to which those states agreed to participate in a multistate arbitration of issues related to the 2003 NPM Adjustment. Under the Arbitration Agreement, the signing states had their ultimate liability, if any, with respect to the 2003 NPM Adjustment reduced by 20%, and RJR Tobacco Company and the other PMs that placed their share of the disputed 2005 NPM Adjustment (discussed below) into the disputed payments account, without releasing or waiving any claims, authorized the release of those funds to the settling states.

The arbitration panel contemplated by the MSA and the Arbitration Agreement was selected, and proceedings before the panel with respect to the 2003 NPM Adjustment claim began in July 2010. Following the completion of document and deposition discovery, on November 3, 2011, RJR Tobacco Company and the other PMs advised the Arbitration Panel that they were not contesting the "diligent enforcement" of 12 states and the four U.S. territories with a combined allocable share of less than 14%. The "diligent enforcement" of the remaining 33 settling states, the District of Columbia and Puerto Rico was contested and became the subject of further proceedings. A common issues hearing was held in April 2012, and state specific evidentiary hearings with respect to the contested states were initiated.

As a result of the partial settlement of certain NPM Adjustment claims, as described in more detail below, as well as the earlier decisions not to contest the diligent enforcement of 12 states, two of which are participants in the partial settlement, and the four U.S. territories, only 15 contested settling states required state specific diligent enforcement rulings. State specific evidentiary hearings were completed in May 2013.

In September 2013, the Arbitration Panel issued rulings with respect to the 15 remaining contested states. The Arbitration Panel ruled that six states — Indiana, Kentucky, Maryland, Missouri, New Mexico and Pennsylvania (collectively representing approximately 14.68% allocable share) — had not diligently enforced their Qualifying Statutes in 2003. Each of these six states filed motions to vacate and/or modify the diligent enforcement rulings on the 2003 NPM Adjustment claim. The status as to each of these states is as follows:

- Indiana and Kentucky (representing approximately 3.80% allocable share) subsequently joined the partial settlement of certain NPM Adjustment claims, as described in more detail below. Indiana participated in a joint motion to stay indefinitely further proceedings on the motions it had filed to vacate the settlement and to modify the adverse diligent enforcement ruling against it. Similarly, Kentucky has joined in a stipulation by the parties filed with the court in that state to stay further proceedings on its motions, but that stipulation has not yet been signed by the court.
- Pennsylvania dropped its challenge to the finding of non-diligence entered against it. However, the state court in Pennsylvania entered an order that modified the judgment reduction method that had been adopted by the Arbitration Panel, which reduced RJR Tobacco Company's and Lorillard Tobacco's recovery from this state by $54.0 million and $9.5 million, respectively. Upon appeal, in April 2015, the intermediate appellate court in Pennsylvania upheld the trial court ruling. The Pennsylvania Supreme Court declined to take the industry's appeal of that ruling. RJR Tobacco Company filed a petition for writ of certiorari with the U.S. Supreme Court on April 21, 2016. On October 11, 2016, the U.S. Supreme Court denied RJR Tobacco Company's petition for writ of certiorari.
- Missouri dropped its challenge to the finding of non-diligence entered against it. However, the state court in Missouri entered an order that modified the judgment reduction method that had been adopted

by the Arbitration Panel which reduced RJR Tobacco Company's and Lorillard Tobacco's recovery from this state by $21.4 million and $3.8 million, respectively. Upon appeal, in September 2015, the intermediate appellate court in Missouri reversed the trial court ruling. Missouri appealed that ruling to the Missouri Supreme Court. On February 14, 2017, the Missouri Supreme Court ruled that the judgment reduction method adopted by the Arbitration Panel should be modified as originally ordered by the court.

- Maryland dropped its challenge to the finding of non-diligence entered against it. Maryland's motion challenging the judgment reduction method adopted by the Arbitration Panel was denied by its state court. Upon appeal, in October 2015, the intermediate appellate court in Maryland reversed the trial court, the effect of which was to reduce RJR Tobacco Company's and Lorillard Tobacco's recovery from this state by a total of $21.2 million and $3.7 million, respectively. The Maryland Supreme Court declined to take the industry's appeal of that ruling. RJR Tobacco Company filed a petition for writ of certiorari with the U.S. Supreme Court on June 22, 2016. On October 11, 2016, the U.S. Supreme Court denied RJR Tobacco Company's petition for writ of certiorari.

- New Mexico filed motions challenging the finding of non-diligence and seeking a modification of the judgment reduction method adopted by the Arbitration Panel. The New Mexico trial court denied the state's motion to vacate the finding of non-diligence, but granted the state's motion challenging the judgment reduction method that had been adopted by the Arbitration Panel, which reduced RJR Tobacco Company's and Lorillard Tobacco's recovery from this state by $5.6 million and $1 million, respectively. RJR Tobacco Company has appealed the court's ruling on the judgment reduction method. The State did not appeal the trial court's denial of its motion to vacate the finding on non-diligence.

The effect from the four non-diligent states, Pennsylvania, Missouri, Maryland and New Mexico, no longer challenging the findings of non-diligence entered against them by the Arbitration Panel was that a certain portion of the potential recovery from these four states was probable and reasonably estimable. Consequently, $6 million and $93 million was recognized as a reduction of cost of products sold in RAI's consolidated statements of income for the year ended December 31, 2016 and 2015, respectively.

RJR Tobacco Company now estimates that the maximum remaining amount of its claim and Lorillard Tobacco's claim with respect to the 2003 NPM Adjustment claim is $6 million and $1 million, respectively, plus any applicable interest and earnings. Until such time RJR Tobacco Company's appeal of the New Mexico state court's ruling that modified the judgment reduction method adopted by the Arbitration Panel has been resolved, including any necessary appeals, uncertainty exists as to the timing, process and amount of RJR Tobacco Company's ultimate recovery with respect to its remaining share of the 2003 NPM Adjustment claim and, accordingly, no additional amounts have been recognized in the RAI Group's unaudited condensed consolidated financial statements as of June 30, 2017, included in this Offering Memorandum.

NPM Adjustment Claims for 2004-2016

From 2006 to 2008, proceedings (including significant factor arbitrations before an independent economic consulting firm) were initiated with respect to the NPM Adjustment for 2004, 2005 and 2006. Ultimately, the Adjustment Requirements were satisfied with respect to each of these NPM Adjustments.

In subsequent years, RJR Tobacco Company, Lorillard Tobacco, certain other PMs and the settling states entered into three separate agreements, covering fiscal years 2007 to 2009, fiscal years 2010 to 2012, fiscal years 2013 to 2014, and fiscal years 2015 to 2017, respectively, wherein the settling states would not contest that the disadvantages of the MSA were "a significant factor contributing to" the market share loss experienced by the PMs in those years. The stipulation pertaining to each of the years covered by the four agreements became effective in February of the year a final determination by the firm of independent economic consultants would otherwise have been expected if the issue had been arbitrated on the merits. For fiscal years 2015 to 2017, RJR Tobacco Company and Philip Morris USA Inc. paid certain amounts to certain of the settling states for each year covered by these agreements, with RJR Tobacco Company paying approximately 67% of such amounts.

Based on the payment calculations of the Independent Auditor and the agreements described above regarding the significant factor determinations, the Adjustment Requirements have been satisfied with respect to the NPM Adjustments for fiscal years 2007 to 2014. The approximate maximum principal amounts of RJR Tobacco Company's and Lorillard Tobacco's shares of the disputed NPM Adjustments for the years 2004 through 2014 (in millions), as currently calculated by the Independent Auditor, and the remaining amounts after the settlements of certain NPM Adjustments claims (see below), are as follows[1]:

	RJR Tobacco Company		**Lorillard Tobacco**	
Volume Year	**Disputed**	**Remaining after settlements**	**Disputed**	**Remaining after settlements**
		(in millions of dollars)		
2004	562	200	111	39
2005	445	158	76	27
2006	419	149	73	26
2007	435	157	83	30
2008	468	169	104	38
2009	472	171	107	39
2010	470	170	119	44
2011	422	152	88	32
2012	430	156	97	36
2013	457	165	92	34
2014	433	156	93	34

(1) The amounts shown above do not include the interest or earnings thereon to which RJR Tobacco Company and Lorillard Tobacco believe they would be entitled under the MSA.

In addition to the above, SFNTC's portion of the disputed NPM Adjustments for the years 2004 through 2014 is approximately $67 million and the remaining amount after the settlements is approximately $25 million.

The 2015 volume year NPM Adjustments for RJR Tobacco Company, Lorillard Tobacco and SFNTC are $482 million, $41 million, and $18 million, respectively.

The 2016 volume year NPM Adjustments for RJR Tobacco Company and SFNTC are $505 million and $22 million, respectively.

The 2004 NPM Adjustment proceeding is underway before two overlapping panels, with one panel hearing the issues with respect to five states and the other panel hearing the issues as to the remaining states that will be part of the arbitration. A revised case management order governing the arbitration was entered on January 4, 2017. Under the timing established by that case management order, discovery in the arbitration proceedings was completed by the end of the second quarter of 2017. A hearing on common issues took place starting in June 2017. State specific evidentiary hearings will begin in the fourth quarter of 2017 and will likely conclude by the end of the third quarter of 2018. Diligent enforcement rulings from the panels are likely by the end of the fourth quarter of 2018. RJR Tobacco Company's and Lorillard Tobacco's remaining claim with respect to 2004 is approximately $239 million collectively.

Missouri obtained an order from the Missouri court of appeals for a separate state specific arbitration of the diligent enforcement issue, but on appeal, the Missouri Supreme Court ordered Missouri to participate in the nationwide arbitration of the 2004 NPM Adjustment. Also, in the context of the 2003 NPM Adjustment proceedings, Montana obtained a ruling from the Montana Supreme Court that the issue of diligent enforcement under the MSA must be heard before that state's MSA court. Finally, New Mexico and the four U.S. territories have been asked to join the 2004 NPM Adjustment Arbitration, but have not yet done so. New Mexico has, however, been ordered by its state court to participate in the nationwide arbitration, although it is appealing that order.

Due to the uncertainty over the final resolution of the 2004-2016 NPM Adjustment claims asserted by RJR Tobacco Company (including Lorillard Tobacco claims) and SFNTC, no assurances can be made related to the amounts, if any, that will be realized or any amounts (including interest) that will be owed, except as described below related to the partial settlement of certain NPM Adjustment claims.

Settlement/Partial Settlement of Certain NPM Adjustment Claims

In November 2012, RJR Tobacco Company, certain other PMs and certain settling states entered into a Term Sheet that set forth terms on which accrued and potential NPM Adjustment claims for 2003 through 2014 could be resolved. The Term Sheet also set forth a restructured NPM Adjustment process to be applied on a going-forward basis, starting with the 2013 volume year. The Term Sheet was provided to all of the MSA settling

states for their review and consideration. A total of 17 states, the District of Columbia and Puerto Rico, collectively representing approximately 42% allocable share, joined the proposed settlement. RJR Tobacco Company and the other PMs indicated that they were prepared to go forward with the proposed settlement with that level of jurisdictional participation.

The Term Sheet provided that the Arbitration Panel in place to deal with the 2003 NPM Adjustment (and other NPM Adjustment-related matters) must review the proposed settlement and enter an appropriate order to confirm for the Independent Auditor that it should implement, as necessary, the terms of the settlement agreement.

In March 2013, the Arbitration Panel entered a Stipulated Partial Settlement and Award, referred to as the Award, reflecting the financial terms of the Term Sheet. Shortly thereafter, the Independent Auditor issued a notice indicating that it intended to implement the financial provisions of the Term Sheet, and also issued various revised payment calculations pertaining to payment years 2009 through 2012 and final calculations pertaining to payment year 2013 that reflected implementation of the financial provisions of the Term Sheet.

Subsequently in 2013, Oklahoma, Connecticut and South Carolina joined the Term Sheet. Efforts by two states, Colorado and Ohio, to obtain injunctions to prevent implementation of the Award were unsuccessful that year.

In June 2014, Kentucky and Indiana, both of which were among the states found "non-diligent" by the Arbitration Panel, joined the Term Sheet on financial terms more favorable to the industry than those agreed to by the original signatory states. In April 2017, Rhode Island and Oregon joined the Term Sheet settlement. Twenty-six jurisdictions have now joined the Term Sheet settlement representing approximately 51.73% allocable share.

On October 20, 2015, RJR Tobacco Company and certain other PMs (including SFNTC) entered into the NY Settlement Agreement with the State of New York to settle certain claims related to the NPM Adjustment. The NY Settlement Agreement resolves NPM Adjustment claims related to payment years from 2004 through 2014 and puts in place a new method to determine future adjustments from 2015 forward as to New York. With the addition of New York's allocable share of 12.76%, RJR Tobacco Company has resolved the 2004 through 2014 NPM Adjustments with 27 jurisdictions, representing approximately 64.49% allocable share.

For additional information related to the Term Sheet and the NY Settlement Agreement, see "— *Cost of Products Sold*" in note 1.

Other Litigation and Developments

JTI Claims for Indemnification

By a purchase agreement dated March 9, 1999, amended and restated as of May 11, 1999, referred to as the 1999 Purchase Agreement, R.J. Reynolds Tobacco Holdings, Inc. and RJR Tobacco Company sold its international tobacco business to JTI. Under the 1999 Purchase Agreement, R.J. Reynolds Tobacco Holdings, Inc. and RJR Tobacco Company retained certain liabilities relating to the international tobacco business sold to JTI. Under its reading of the indemnification provisions of the 1999 Purchase Agreement, JTI has requested indemnification for damages allegedly arising out of these retained liabilities. As previously reported, a number of the indemnification claims between the parties relating to the activities of Northern Brands in Canada have been resolved. The other matters for which JTI has requested indemnification for damages under the indemnification provisions of the 1999 Purchase Agreement are described below:

- In a letter dated March 31, 2006, counsel for JTI stated that JTI would be seeking indemnification under the 1999 Purchase Agreement for any damages it may incur or may have incurred arising out of a Southern District of New York grand jury investigation, a now-terminated Eastern District of North Carolina grand jury investigation, and various actions filed by the European Community and others in the U.S. District Court for the Eastern District of New York, referred to as the EDNY, against RJR Tobacco Company and certain of its affiliates on November 3, 2000, August 6, 2001, and (as discussed in greater detail below) October 30, 2002, and against JTI on January 11, 2002.
- JTI also has sought indemnification relating to a Statement of Claim filed on April 23, 2010, in the Ontario Superior Court of Justice, London, against JTI Macdonald Corp., referred to as JTI-MC, by the Ontario Flue-Cured Tobacco Growers' Marketing Board, referred to as the Board, Andy J. Jacko, Brian Baswick, Ron Kichler, and Aprad Dobrenty, proceeding on their own behalf and on behalf of a putative class of Ontario tobacco producers that sold tobacco to JTI-MC during the period between January 1, 1986 and December 31, 1996, referred to as the Class Period, through the Board pursuant to certain agreements. The Statement of Claim seeks recovery for damages allegedly incurred by the class

representatives and the putative class for tobacco sales during the Class Period made at the contract price for duty free or export cigarettes with respect to cigarettes that, rather than being sold duty free or for export, purportedly were sold in Canada, which allegedly breached one or more of a series of contracts dated between June 4, 1986, and July 3, 1996. Appeals taken from an unsuccessful motion to dismiss the action as barred by the statute of limitations were ultimately denied on November 4, 2016. Certification proceedings are pending.

- Finally, JTI has advised R.J. Reynolds Tobacco Holdings, Inc. and RJR Tobacco Company of its view that, under the terms of the 1999 Purchase Agreement, R.J. Reynolds Tobacco Holdings, Inc. and RJR Tobacco Company are liable for approximately $1.85 million related to a judgment entered in 1998, plus interest and costs, in an action filed in Brazil by Lutz Hanneman, a former employee of a former RJR Tobacco Company subsidiary. R.J. Reynolds Tobacco Holdings, Inc. and RJR Tobacco Company deny that they are liable for this judgment under the terms of the 1999 Purchase Agreement.

Although R.J. Reynolds Tobacco Holdings, Inc. and RJR Tobacco Company recognize that, under certain circumstances, they may have these and other unresolved indemnification obligations to JTI under the 1999 Purchase Agreement, R.J. Reynolds Tobacco Holdings, Inc. and RJR Tobacco Company disagree with JTI as to (1) what circumstances relating to any such matters may give rise to indemnification obligations by R.J. Reynolds Tobacco Holdings, Inc. and RJR Tobacco Company, and (2) the nature and extent of any such obligation. R.J. Reynolds Tobacco Holdings, Inc. and RJR Tobacco Company have conveyed their position to JTI, and the parties have agreed to resolve their differences at a later time.

European Community

In *European Community v. RJR Nabisco, Inc.* (U.S.D.C. E.D.N.Y., filed 2002), the European Community and several of its member states allege that R.J. Reynolds Tobacco Holdings, Inc., RJR Tobacco Company and other currently and formerly related companies engaged in money laundering and other conduct violating civil RICO and a variety of common laws. The plaintiffs also allege that the defendants manufactured cigarettes that were eventually sold in Iraq in violation of U.S. sanctions. The plaintiffs seek compensatory, punitive and treble damages among other types of relief. On February 15, 2010, the defendants moved to dismiss, and the action has been stayed and largely inactive since then while the parties have litigated that motion. On March 8, 2011, the district court granted the defendants' motion in part and dismissed the plaintiffs' RICO claims. On May 13, 2011, the district court granted the remaining portion of the defendants' motion and dismissed the plaintiffs' state-law claims based on the court's lack of subject matter jurisdiction. The plaintiffs appealed to the Second Circuit.

On April 29, 2014, the Second Circuit vacated and remanded in a decision concluding that (1) as pled, the RICO claims are within the scope of the RICO statute, and (2) the federal court has subject matter jurisdiction over the state-law claims. The defendants sought rehearing and rehearing *en banc*. On August 20, 2014, the Second Circuit denied panel rehearing and issued an amended opinion that, in addition to adhering to the earlier opinion, held that a civil RICO cause of action extends to extraterritorial injuries. The U.S. Supreme Court granted certiorari and, on June 20, 2016, reversed the Second Circuit's decision and ordered the dismissal of the plaintiffs' RICO damages claims, finding that RICO civil causes of action extend only to domestic injuries, which claims the plaintiffs had abandoned. The court also held that any private RICO claims for equitable relief must also rest on domestic injuries but reserved decision on whether the plaintiffs had alleged such claims. The court's decision does not affect the plaintiffs' common-law claims. After remand, the district court entered an order allowing the plaintiffs to file an amended complaint by October 24, 2016, which later was extended indefinitely. Once the amended complaint is filed, the parties have been directed to submit a joint briefing schedule for the defendants' anticipated motion to dismiss. Further, the district court stayed discovery until ten days after entry of an order deciding the defendants' anticipated motion to dismiss.

Fontem Patent Litigation

On April 4, 2016, a case was filed in federal court, *Fontem Ventures B.V. and Fontem Holdings 1 B.V. v. R. J. Reynolds Vapor Company* (U.S.D.C. C.D. Cal.), which alleges that VUSE products infringe four patents owned by Fontem purportedly directed to e-cigarettes. On May 3, 2016, Fontem filed a second complaint asserting that the VUSE products infringe two additional Fontem patents purportedly directed to e-cigarettes. On June 22, 2016, Fontem filed a third complaint asserting that the VUSE products infringe one additional Fontem patent purportedly directed to e-cigarettes. RJR Vapor filed an answer in the first case on June 27, 2016, and an amended answer on July 25, 2016. RJR Vapor also filed answers in the second and third cases on July 25, 2016. On June 29, 2016, RJR Vapor filed a motion to transfer the three cases to the Middle District of North Carolina, which was granted on August 8, 2016. On December 14, 2016, the transferred cases were consolidated with the lead case, *Fontem Ventures B.V. and Fontem Holdings 1 B.V. v. R. J. Reynolds Vapor Company,* 16-cv-1255

(M.D.N.C.). On March 1, 2017, Fontem filed a fourth complaint in the Middle District of North Carolina asserting that the VUSE products infringe eight additional Fontem patents. RJR Vapor filed an answer to the fourth complaint on April 24, 2017. On April 14, 2017, Fontem filed a motion to amend the consolidated three prior actions to add certain Reynolds entities as additional defendants, which was denied as moot on May 30, 2017, due to an agreed stipulation where the additional Reynolds entities agreed to be bound by any judgment and to provide discovery as if they were named parties. On May 9, 2017, the fourth action was also consolidated with the lead case.

Also, to date, RJR Vapor has filed multiple petitions for *inter partes* review against seven of the 15 asserted patents. Three of the petitions have been granted, five denied, and the others are still pending decision.

FDA Litigation

On February 25, 2011, RJR Tobacco Company, Lorillard and Lorillard Tobacco jointly filed a lawsuit, *Lorillard, Inc. v. U.S. Food and Drug Administration*, in the U.S. District Court for the District of Columbia, challenging the composition of TPSAC which had been established by the FDA under the Family Smoking Prevention and Tobacco Control Act, referred to as the FDA Tobacco Act. The complaint alleges that certain members of the TPSAC and certain members of its Constituents Subcommittee have financial and appearance conflicts of interest that are disqualifying under federal ethics law and regulations, and that the TPSAC is not "fairly balanced," as required by the Federal Advisory Committee Act, referred to as FACA. In March 2011, the plaintiffs filed an amended complaint, which added an additional claim, based on a nonpublic meeting of members of the TPSAC, in violation of the FACA. The court granted the plaintiffs' unopposed motion to file a second amended complaint adding a count addressing the FDA's refusal to produce all documents generated by the TPSAC and its subcommittee in preparation of the menthol report. On July 21, 2014, the court granted the plaintiffs' summary judgment motions finding that three members of the TPSAC Committee had impermissible conflicts of interest. As relief, the court ordered the FDA to reconstitute the committee in conformance with the law and enjoined the agency from using or relying on the TPSAC's 2011 Menthol Report. On September 18, 2014, the FDA appealed the decision to the D.C. Circuit. On January 15, 2016, the appellate court reversed the decision of the district court, finding that the plaintiffs did not have standing to challenge appointments of certain TPSAC members. Under the appellate court's order, the three former committee members can serve once again on the TPSAC and FDA can rely on the TPSAC menthol report. On May 9, 2016, the plaintiffs' petition for rehearing or rehearing *en banc* was denied. On May 18, 2016, the appellate court issued a mandate vacating the injunction that had barred use of the TPSAC menthol report and had ordered reconstitution of the TPSAC.

For a detailed description of the FDA Tobacco Act, see "*Business of RAI — Governmental Activity*".

Oklahoma Tax Litigation

On June 7, 2017, Philip Morris USA Inc. and R. J. Reynolds Tobacco Company, among others, filed suit in the Oklahoma Supreme Court alleging that the Oklahoma legislature improperly enacted legislation that would increase the price of cigarettes by $1.50 per pack because the legislature failed to abide by the State's procedures for passing a tax measure. The Oklahoma Supreme Court will hear oral argument on August 8, 2017.

Smokeless Tobacco Litigation

In 1999, when the IPIC litigation was first filed, the named defendants included manufacturers of smokeless products, including Conwood Company, LLC (now known as American Snuff Company, LLC) and others. When the IPIC plaintiffs filed discovery responses in IPIC listing the products they used, 41 of them listed a smokeless product. Six of those 41 plaintiffs listed a brand owned by American Snuff (Levi Garrett). Seven listed a brand (Beechnut) once manufactured by Lorillard Tobacco (now manufactured by National Tobacco Company). On December 3, 2001, the IPIC court severed all smokeless claims and all smokeless defendants from IPIC. There was no order staying the case during IPIC. In the ensuing 15 years, the plaintiffs in the severed cases did nothing to pursue the cases. The plaintiffs now seek to activate various smokeless claims, including certain plaintiffs whose cases were dismissed in IPIC after severance of the smokeless claims and whose claims are not counted in the 41 claims described above. After a status conference on July 11, 2016, the court set a schedule for briefing the issue of whether the severed claims should be dismissed because of the prolonged inaction in the case. On January 25, 2017, the trial court denied the defendants' motion to dismiss those claims as abandoned. The plaintiffs are now free to move forward with their claims, and an initial schedule for discovery has been set through 2019.

ERISA Litigation

In May 2002, in *Tatum v. The R.J.R. Pension Investment Committee of the R. J. Reynolds Tobacco Company Capital Investment Plan*, an employee of RJR Tobacco Company filed a class-action suit in the U.S. District

Court for the Middle District of North Carolina, alleging that the defendants, R.J. Reynolds Tobacco Holdings, Inc. RJR Tobacco Company, the RJR Employee Benefits Committee and the RJR Pension Investment Committee, violated the Employee Retirement Income Security Act of 1974, referred to as ERISA. The actions about which the plaintiff complains stem from a decision made in 1999 by RJR Nabisco Holdings Corp., subsequently renamed Nabisco Group Holdings Corp., referred to as NGH, to spin off R.J. Reynolds Tobacco Holdings, Inc. thereby separating NGH's tobacco business and food business. As part of the spin-off, the 401(k) plan for the previously related entities had to be divided into two separate plans for the now separate tobacco and food businesses. The plaintiff contends that the defendants breached their fiduciary duties to participants of the RJR 401(k) plan when the defendants removed the stock funds of the companies involved in the food business, NGH and Nabisco Holdings Corp., referred to as Nabisco, as investment options from the RJR 401(k) plan approximately six months after the spin-off. The plaintiff asserts that a November 1999 amendment (the "1999 Amendment") that eliminated the NGH and Nabisco funds from the RJR 401(k) plan on January 31, 2000, contained sufficient discretion for the defendants to have retained the NGH and Nabisco funds after January 31, 2000, and that the failure to exercise such discretion was a breach of fiduciary duty. In his complaint, the plaintiff requests, among other things, that the court require the defendants to pay as damages to the RJR 401(k) plan an amount equal to the subsequent appreciation that was purportedly lost as a result of the liquidation of the NGH and Nabisco funds.

In July 2002, the defendants filed a motion to dismiss, which the court granted in December 2003. In December 2004, the U.S. Court of Appeals for the Fourth Circuit reversed the dismissal of the complaint, holding that the 1999 Amendment did contain sufficient discretion for the defendants to have retained the NGH and Nabisco funds as of February 1, 2000, and remanded the case for further proceedings. The court granted the plaintiff leave to file an amended complaint and denied all pending motions as moot. In April 2007, the defendants moved to dismiss the amended complaint. The court granted the motion in part and denied it in part, dismissing all claims against the RJR Employee Benefits Committee and the RJR Pension Investment Committee. The plaintiff filed a motion for class certification, which the court granted in September 2008.

A non-jury trial was held in January and February 2010. On February 25, 2013, the district court dismissed the case with prejudice, finding that a hypothetical prudent fiduciary could have made the same decision and thus the plan's loss was not caused by the procedural prudence which the court found to have existed. On August 4, 2014, the Fourth Circuit Court of Appeals, referred to as Fourth Circuit, reversed, holding that the district court applied the wrong standard when it held that the defendants did not cause any loss to the plan, determined the test was whether a hypothetical prudent fiduciary would have made the same decision and remanded the case back to the district court to apply the "would have standard." On February 18, 2016, the district court dismissed the case with prejudice, finding that the defendants have shown by a preponderance of the evidence that a fiduciary acting with prudence would have divested the NGH and Nabisco Funds at the time and in the manner that the defendants did. On March 17, 2016, the plaintiff appealed arguing that the district court erred in finding that a hypothetical prudent fiduciary would have divested the NGH and Nabisco Funds at the same time and in the same manner as R.J. Reynolds Tobacco Holdings, Inc. On April 28, 2017, the Fourth Circuit affirmed the district court's judgment in favor of R.J. Reynolds Tobacco Holdings, Inc. The plaintiff filed a petition for rehearing *en banc* on May 12, 2017, which was denied on May 26, 2017. The plaintiff agreed to forgo filing a petition for writ of certiorari with the U.S Supreme Court in exchange for R.J. Reynolds Tobacco Holdings, Inc. withdrawing its motion for costs in the district court. Therefore, the matter has concluded.

Environmental Matters

RAI and its subsidiaries are subject to federal, state and local environmental laws and regulations concerning the discharge, storage, handling and disposal of hazardous or toxic substances. Such laws and regulations provide for significant fines, penalties and liabilities, sometimes without regard to whether the owner or operator of the property or facility knew of, or was responsible for, the release or presence of hazardous or toxic substances. In addition, third parties may make claims against owners or operators of properties for personal injuries and property damage associated with releases of hazardous or toxic substances. In the past, RJR Tobacco Company has been named a potentially responsible party with third parties under the Comprehensive Environmental Response, Compensation and Liability Act with respect to several superfund sites. RAI and its subsidiaries are not aware of any current environmental matters that are expected to have a material adverse effect on the business, results of operations or financial position of RAI or its subsidiaries.

RAI and its operating subsidiaries believe that climate change is an environmental issue primarily driven by carbon dioxide emissions from the use of energy. RAI's operating subsidiaries are working to reduce carbon dioxide emissions by minimizing the use of energy where cost effective, minimizing waste to landfills and increasing recycling. Climate change is not viewed by RAI's operating subsidiaries as a significant direct economic risk to their businesses, but rather an indirect risk involving the potential for a longer-term general

increase in the cost of doing business. Regulatory changes are difficult to predict, but the current regulatory risks to the business of RAI's operating subsidiaries with respect to climate change are relatively low. Financial impacts will be driven more by the cost of natural gas and electricity. Efforts are made to anticipate the effect of increases in fuel costs directly impacting RAI's operating subsidiaries by evaluating natural gas usage and market conditions. Occasionally forward contracts are purchased, limited to a two-year period, for natural gas. In addition, RAI's operating subsidiaries are continually evaluating energy conservation measures and energy efficient equipment to mitigate impacts of increases in energy costs, and adopting or utilizing such measures and equipment where appropriate.

Regulations promulgated by the EPA and other governmental agencies under various statutes have resulted in, and likely will continue to result in, substantial expenditures for pollution control, waste treatment or handling, facility modification and similar activities. RAI and its subsidiaries are engaged in a continuing program to comply with federal, state and local environmental laws and regulations, and dependent upon the probability of occurrence and reasonable estimation of cost, accrue or disclose any material liability. Although it is difficult to reasonably estimate the portion of capital expenditures or other costs attributable to compliance with environmental laws and regulations, RAI does not expect such expenditures or other costs to have a material adverse effect on the business, results of operations, cash flows or financial position of RAI or its subsidiaries.

Shareholder Cases

Lorillard Transaction

RAI, the members of the RAI board of directors and BAT have been named as defendants in a putative class-action lawsuit captioned *Corwin v. British American Tobacco PLC*, brought in North Carolina state court, referred to as *Corwin*, by a person identifying himself as a shareholder of RAI. *Corwin* was initiated on August 8, 2014, and an amended complaint was filed on November 7, 2014. The amended complaint generally alleges, among other things, that the members of the RAI board of directors breached their fiduciary duties to RAI shareholders by approving the share purchase by BAT and the sharing of technology with BAT, as well as that there were various conflicts of interest in the transaction. More specifically, the amended complaint alleges that (1) RAI aided and abetted the alleged breaches of fiduciary duties by its board of directors and (2) BAT was a controlling shareholder of RAI and, as a consequence, owed other RAI shareholders fiduciary duties in connection with the BAT Share Purchase. *Corwin* seeks injunctive relief, damages and reimbursement of costs, among other remedies. On January 2, 2015, the plaintiff in *Corwin* filed a motion for a preliminary injunction seeking to enjoin temporarily the RAI shareholder meeting and votes scheduled for January 28, 2015. RAI and the RAI board of directors timely opposed that motion prior to a hearing that was scheduled to occur on January 16, 2015.

RAI believed that *Corwin* was without merit and that no further disclosure was necessary to supplement the Joint Proxy Statement/Prospectus under applicable laws. However, to eliminate certain burdens, expenses and uncertainties, on January 17, 2015, RAI and the director defendants in *Corwin* entered into the North Carolina Memorandum of Understanding regarding the settlement of the disclosure claims asserted in that lawsuit. The North Carolina Memorandum of Understanding outlines the terms of the parties' agreement in principle to settle and release the disclosure claims which were or could have been asserted in *Corwin*. In consideration of the partial settlement and release, RAI agreed to make certain supplemental disclosures to the Joint Proxy Statement/ Prospectus, which it did on January 20, 2015. On August 4, 2015, the trial court granted the defendants' motions to dismiss all of the remaining non-disclosure claims. The plaintiff appealed. On February 17, 2016, the trial court approved the partial settlement, including the plaintiff's unopposed request for $415,000 in attorneys' fees and costs. The partial settlement did not affect the consideration paid to Lorillard shareholders in connection with the Lorillard merger. On December 20, 2016, the North Carolina Court of Appeals affirmed the trial court's dismissal of the claims against RAI and RAI's board of directors on the grounds that the plaintiff could not state a direct claim against RAI's board of directors for breach of fiduciary duties. The Court of Appeals reversed the dismissal of the claims against BAT. On January 4, 2017, BAT filed a motion for rehearing *en banc* of the Court of Appeals' opinion, which was denied on February 2, 2017. BAT petitioned the North Carolina Supreme Court for review of the Court of Appeals' decision, which was accepted on June 9, 2017.

BAT Merger

In connection with the merger, two putative class action lawsuits were filed in the United States District Court for the Middle District of North Carolina against RAI and the members of the RAI board of directors. The two lawsuits are captioned *Drew v. Reynolds American Inc., et al.*, No. 1:17-cv-00547 (filed June 16, 2017) and *Sneed v. Reynolds American Inc., et al.*, No. 1:17-cv-00584 (filed June 26, 2017) (collectively, the "merger litigation"). The complaints, which were filed by alleged RAI shareholders, generally alleged that the definitive

proxy statement that RAI filed with the SEC on June 14, 2017 (the "RAI Proxy Statement"), omitted certain material information in connection with the merger in violation of Sections 14(a) and 20(a) of the Exchange Act. The complaints sought injunctive relief to prevent the consummation of the merger unless the allegedly material information was disclosed, damages and attorneys' fees and costs.

RAI believed that the claims asserted in the merger litigation were without merit and no supplemental disclosure was required under applicable law. However, in order to avoid the risk of the merger litigation delaying or adversely affecting the merger and to minimize the costs, risks and uncertainties inherent in litigation, and without admitting any liability or wrongdoing, on July 11, 2016, RAI filed supplemental disclosures to the RAI Proxy Statement with certain additional information relating to the merger.

Other Contingencies

JTI Indemnities

In connection with the sale of the international tobacco business to JTI, pursuant to the 1999 Purchase Agreement, R.J. Reynolds Tobacco Holdings, Inc. and RJR Tobacco Company agreed to indemnify JTI against:

- any liabilities, costs and expenses arising out of the imposition or assessment of any tax with respect to the international tobacco business arising prior to the sale, other than as reflected on the closing balance sheet;
- any liabilities, costs and expenses that JTI or any of its affiliates, including the acquired entities, may incur after the sale with respect to any of R.J. Reynolds Tobacco Holdings, Inc.'s or RJR Tobacco Company's employee benefit and welfare plans; and
- any liabilities, costs and expenses incurred by JTI or any of its affiliates arising out of certain activities of Northern Brands.

As described above in "*— Litigation Affecting the Cigarette Industry — Other Litigation and Developments — JTI Claims for Indemnification*," RJR Tobacco Company has received claims for indemnification from JTI, and several of these have been resolved. Although R.J. Reynolds Tobacco Holdings, Inc. and RJR Tobacco Company recognize that, under certain circumstances, they may have other unresolved indemnification obligations to JTI under the 1999 Purchase Agreement, R.J. Reynolds Tobacco Holdings, Inc. and RJR Tobacco Company disagree what circumstances described in such claims give rise to any indemnification obligations by R.J. Reynolds Tobacco Holdings, Inc. and RJR Tobacco Company and the nature and extent of any such obligation. R.J. Reynolds Tobacco Holdings, Inc. and RJR Tobacco Company have conveyed their position to JTI, and the parties have agreed to resolve their differences at a later date.

In connection with the sale of the international rights to the Natural American Spirit brand name and associated trademarks to JTI Holding, along with the international companies that distribute and market the brand outside the United States, pursuant to the 2015 Purchase Agreement, SFNTC, R. J. Reynolds Global Products, Inc., and R. J. Reynolds Tobacco B.V. agreed to indemnify JTI Holding against, among other things, any liabilities, costs, and expenses relating to actions:

- commenced on or before (1) January 13, 2019, to the extent relating to alleged personal injuries, and (2) in all other cases, January 13, 2021;
- brought by (1) a governmental authority to enforce legislation implementing European Union Directive 2001/37/EC or European Directive 2014/40/EU or (2) consumers or a consumer association; and
- arising out of any statement or claim (1) made on or before January 13, 2016, (2) by any company sold to JTI Holding in the transaction, (3) concerning Natural American Spirit brand products consumed or intended to be consumed outside of the United States and (4) that the Natural American Spirit brand product is natural, organic, or additive free.

ITG Indemnity

In the purchase agreement relating to the Lorillard Divestiture, RAI agreed to defend and indemnify, subject to certain conditions and limitations, ITG in connection with claims relating to the purchase or use of one or more of the Winston, Kool, Salem, or Maverick cigarette brands on or before June 12, 2015, as well as in actions filed before June 13, 2023, relating to the purchase or use of one or more of the Winston, Kool, Salem, or Maverick cigarette brands. In the purchase agreement relating to the Lorillard Divestiture, ITG agreed to defend and indemnify, subject to certain conditions and limitations, RAI and its affiliates in connection with claims relating to the purchase or use of blu brand e-cigarettes. ITG also agreed to defend and indemnify, subject to certain conditions and limitations, RAI and its affiliates in actions filed after June 12, 2023, relating to the purchase or use of one or more of the Winston, Kool, Salem, or Maverick cigarette brands after June 12, 2015.

Loews Indemnity

In 2008, Loews Corporation, referred to as Loews, entered into an agreement with Lorillard, Lorillard Tobacco, and certain of their affiliates, which agreement is referred to as the Separation Agreement. In the Separation Agreement, Lorillard agreed to indemnify Loews and its officers, directors, employees and agents against all costs and expenses arising out of third party claims (including, without limitation, attorneys' fees, interest, penalties and costs of investigation or preparation of defense), judgments, fines, losses, claims, damages, liabilities, taxes, demands, assessments, and amounts paid in settlement based on, arising out of or resulting from, among other things, Loews's ownership of or the operation of Lorillard and its assets and properties, and its operation or conduct of its businesses at any time prior to or following the separation of Lorillard and Loews (including with respect to any product liability claims). Loews is a defendant in three pending product liability actions, each of which is a putative class action. Pursuant to the Separation Agreement, Lorillard is required to indemnify Loews for the amount of any losses and any legal or other fees with respect to such cases. Following the closing of the Lorillard merger, RJR Tobacco Company assumed Lorillard's obligations under the Separation Agreement as was required under the Separation Agreement.

Indemnification of Distributors and Retailers

RJR Tobacco Company, Lorillard Tobacco, SFNTC, American Snuff Co. and RJR Vapor have entered into agreements to indemnify certain distributors and retailers from liability and related defense costs arising out of the sale or distribution of their products. Additionally, SFNTC has entered into an agreement to indemnify a supplier from liability and related defense costs arising out of the sale or use of SFNTC's products. The cost has been, and is expected to be, insignificant. RJR Tobacco Company, SFNTC, American Snuff Co. and RJR Vapor believe that the indemnified claims are substantially similar in nature and extent to the claims that they are already exposed to by virtue of their having manufactured those products.

Except as otherwise noted above, RAI is not able to estimate the maximum potential amount of future payments, if any, related to these indemnification obligations.

MANAGEMENT

Board of Directors of BAT

Overview

The BAT board of directors currently consists of 13 directors: the Chairman, two executives, the Chief Executive and the Finance Director together referred to as the Executive Directors, and 11 directors who serve in a non-executive capacity, including the Chairman, referred to as the Non-Executive Directors. The BAT board of directors considers all 11 of BAT's Non-Executive Directors 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 independent judgment and have not previously been involved in the management of the BAT Group. The BAT Group therefore meets the UK Corporate Governance Code requirement that, excluding the Chairman, at least half of the members of the BAT board of directors should meet such criteria. The NYSE rules generally require that listed companies have a majority of independent directors. As a foreign private issuer, the NYSE rules generally permit BAT to follow UK independence rules. For a director to be "independent" under the NYSE rules, the board of directors of a listed company must affirmatively determine that the director has no material relationship with the company, or its subsidiaries or affiliates, either directly or as a partner, shareholder or officer of an organization that has a relationship with the company or its subsidiaries or affiliates.

On July 25, 2017, upon completion of the merger, Lionel L. Nowell, III, Holly Keller Koeppel and Luc Jobin joined the BAT board of directors as independent Non-Executive Directors. The merger agreement provided that three of the RAI directors (other than those nominated by B&W, a BAT subsidiary) would be invited to join the BAT board.

The BAT board of directors is collectively responsible to shareholders of BAT for its performance and for the BAT Group's strategic direction, its values and its governance. The BAT board of directors is responsible for: BAT Group strategy, significant corporate activities, BAT Group policies, Corporate Governance, the BAT board of directors succession plans, BAT Group budget, risk management and internal control, Annual Report approval, periodic financial reporting and dividend policy. The BAT board of directors held six scheduled meetings and three ad hoc meetings in 2016.

The BAT board of directors is also responsible for determining the nature and extent of the significant risks that the BAT Group is willing to take to achieve its strategic objectives and for maintaining sound risk management and internal control systems. It carries out a review of the effectiveness of the BAT Group's risk management and internal control systems annually and reports to shareholders that it has done so. This review covers all material controls including financial, operational and compliance controls and risk management systems. The systems are designed to identify, evaluate and manage risks that may impede the achievement of the BAT Group's business objectives rather than to eliminate them entirely. The system therefore provides a reasonable, not absolute, assurance against material misstatement or loss.

Board Committees

The BAT board of directors has three principal committees to which it has delegated certain responsibilities: the Audit Committee, the Nominations Committee and the Remuneration Committee.

The Audit Committee is responsible for monitoring and reviewing the integrity of the BAT Group's financial statements and any formal announcements relating to the BAT Group's performance, considering any significant issues and judgments reflected in them, before their submission to the BAT board of directors; consistency of the BAT Group's accounting policies; effectiveness of, and making recommendations to the BAT board of directors on, the BAT Group's accounting, risk and internal control systems; effectiveness of the BAT Group's internal audit function; and performance, independence and objectivity of the BAT Group's external auditors, making recommendations as to their reappointment (or for a tender of audit services), and approving their terms of engagement and the level of audit fees. The BAT board of directors believes that two members of its Audit Committee, who have the "recent and relevant financial experience" required by the UK Corporate Governance Code, would be considered independent under SOX standards and would also meet the SOX standards of an audit committee "financial expert". Further, they would be considered "financially literate" under the NYSE Rules and all members of the Audit Committee would meet the requirement of the NYSE Rules of being able to read and understand fundamental financial statements.

The Nominations Committee is responsible for reviewing the structure, size and composition of the BAT board of directors and the BAT Group management board to ensure both have an appropriate balance of skills, expertise, knowledge and (for the BAT board of directors) independence; reviewing the succession plans for the Executive Directors and members of the BAT Group management board; ensuring that the procedure for

appointing directors is rigorous, transparent, objective, merit-based and has regard for diversity; making recommendations to the BAT board of directors on suitable candidates for appointments to the BAT board of directors and the BAT Group management board; and assessing the time needed to fulfill the roles of Chairman, Senior Independent Director and Non-Executive Director, and ensuring Non-Executive Directors have sufficient time to fulfill their duties.

The Remuneration Committee is responsible for agreeing upon and proposing the Remuneration Policy (covering salary, benefits, performance-based variable rewards and pensions) for shareholder approval; determining, within the terms of the Remuneration Policy, the specific remuneration packages for the Chairman and the Executive Directors, both on appointment and on review and, if appropriate, any compensation payment due on termination of appointment; the setting of targets applicable for the BAT Group's performance-based variable reward scheme and determining achievement against those targets, exercising discretion where appropriate and as provided by the applicable scheme rules and the Remuneration Policy; and monitoring and advising the BAT board of directors on any major changes to the policy on employee benefit structures for the BAT Group.

Executive Directors

Nicandro Durante (60), Chief Executive. Mr. Durante was appointed as Chief Executive in March 2011, after being appointed Chief Operating Officer and Director in January 2008, having joined the BAT Group management board as Regional Director for Africa and the Middle East in 2006. He has experience in senior financial and management roles within the BAT Group having overseen operations in the United Kingdom, Hong Kong and Brazil, including his time as President of Souza Cruz. Mr. Durante has been a Non-Executive Director of Reckitt Benckiser Group plc since 2013 and is a member of its Remuneration and Corporate Responsibility, Sustainability and Ethics Committees. The business of Reckitt Benckiser Group plc is consumer goods and the business address is 103-105 Bath Road, Slough, Berkshire, SL1 3UH, United Kingdom. Mr. Durante is a citizen of Brazil and Italy.

Ben Stevens (58), Finance Director. Mr. Stevens has served as Finance Director since April 2008 and Director since March 2008. He previously held the position of Regional Director for Europe from 2004, after having originally joined the BAT Group management board in 2001 as Development Director. He has experience in a number of senior group finance and general management roles within the BAT Group, particularly in Europe and Russia, and was Head of Merger Integration following the merger with Rothmans in 1999. He is currently a Non-Executive Director of ISS A/S. The business of ISS A/S is facility services and the business address is Buddingevej 197, DK-2860, Søborg, Denmark. Mr. Stevens has been a Director of Louisville since July 2008. Mr. Stevens is a citizen of the United Kingdom.

The Chairman

Richard Burrows (71), Chairman and Chairman of the Nominations Committee. Mr. Burrows was appointed Chairman of the BAT board of directors in November 2009, having served as a Non-Executive Director since his appointment to the BAT board of directors in September 2009. He is also the Chairman of the Nominations Committee. Mr. Burrows has been the Chairman of the Craven House Capital plc board of directors since 2016 and is currently Chair of its Nomination, Remuneration and Compliance Committees. The business of Craven House Capital plc is merchant banking and the business address is 776-778 Barking Road, London, E13 9PJ, United Kingdom. Mr. Burrows has served as a Non-Executive Director of Rentokil Initial plc since 2008, where he currently is a member of the Remuneration and Nomination Committees. The business of Rentokil Initial plc is pest control, hygiene services, workwear supply and laundry and the business address is Riverbank, Meadows Business Park, Blackwater, Camberley, Surrey, GU17 9AB, United Kingdom. Mr. Burrows has served as a Supervisory Board member at Carlsberg A/S since 2009, where he is the Chairman of the Remuneration Committee. The business of Carlsberg A/S is a brewery and the business address is 100 Ny Carlsberg Vej, 1799 Copenhagen V, Denmark. Mr. Burrows was formerly the Chairman of the Board of Voicesage Global Holdings Ltd. from 2012 until 2015. The business of Voicesage Global Holdings Ltd. is software consultancy and supply and the business address is Euro House, Euro Business Park, Little Island, Co Cork, 616518, Ireland. Mr. Burrows was formerly a Non-Executive Director of Eurasian Natural Resources Corporation Limited from 2012 until 2013. The business of Eurasian Natural Resources Corporation Limited is iron ore mining and the business address is 5th Floor, 6 St. Andrew Street, London, EC4A 3AE, United Kingdom. He was formerly the Governor of the Bank of Ireland, Chief Executive of Irish Distillers and Co-Chief Executive of Pernod Ricard. Mr. Burrows is a citizen of Ireland.

Non-Executive Directors

Sue Farr (61), Independent Non-Executive Director. Ms. Farr was appointed as a Non-Executive Director in February 2015. She is a member of the Nominations and Remuneration Committees. Ms. Farr has been a Special Advisor at Chime Communications Limited since 2016. The business of Chime Communications Limited is sport and entertainment communications and the business address is 62 Buckingham Gate, London, SW1E 6AJ, United Kingdom. She has been a Non-Executive Director of Dolphin Capital Investors Limited since 2016. The business of Dolphin Capital Investors Limited is real estate investment and the business address is Vanterpool Plaza, 2nd Floor, Wickhams Clay 1, Road Town, Tortola, British Virgin Islands. She has been a Non-Executive Director and Chair of the Nominations and Remuneration Committee of Accsys Technologies plc since 2014. The business of Accsys Technologies plc is chemical technologies and the address is Brettenham House, 2-19 Lancaster Place, London, WC2E 7EN, United Kingdom. She has been a Non-Executive Director and a member of the Nominations Committee of Millennium & Copthorne Hotels plc since 2013, and she also chairs the Remuneration Committee of Millennium & Copthorne Hotels plc. The business of Millennium & Copthorne Hotels plc is hotels and the business address is Victoria House, Victoria Road, Horley, Surrey, RH6 7AF, United Kingdom. She has been a Non-Executive Director and Chair of the Corporate Responsibility Committee of Dairy Crest Group plc since 2011. The business of Diary Crest Group plc is dairy produce and the address is Claygate House, Littleworth Road, Esher, Surrey, KT10 9PN, United Kingdom. She previously served as Executive Director of Business Development for Chime Communications Limited from 2003 until 2016, and as a Non-Executive Director of Motivcom plc from 2008 until 2014. The business of Motivcom is incentives programs and the address is 255 quai de la Bataille de Stalingrad, 92866, Issy-les-Moulineaux, France. Ms. Farr also previously served as a Trustee of Historic Royal Palaces from 2007 until 2013. The business of Historic Royal Palaces is charity and the business address is Hampton Court Palace, East Molesey, KT8 9AU, United Kingdom. She was formerly the Chairwoman of the Marketing Society and the Marketing Group of Great Britain. Ms. Farr is a citizen of the United Kingdom.

Ann Godbehere (62), Independent Non-Executive Director. Ms. Godbehere was appointed as a Non-Executive Director in October 2011. She is a member of the Nominations and Remuneration Committees. She has been a Non-Executive Director and Chair of the Audit Committee of Rio Tinto plc and Rio Tinto Limited since 2010 and Senior Independent Director and a member of the Remuneration Committee of Rio Tinto plc and Rio Tinto Limited since June 2017. The business of Rio Tinto plc is metals and mining and the business address is 120 Collins Street, Melbourne, Australia 3000. The business of Rio Tinto Limited is metals and mining and the business address is 6 St. James's Square, London, SW1Y 4AD, United Kingdom. Ms. Godbehere has been a Non-Executive Director, Chair of the Compensation Committee and member of the Audit Committee of UBS Group AG and UBS AG since 2009. The business of UBS Group AG is banking and the address is Bahnhofstrasse 45, CH-8001, Zurich, Switzerland and Aeschenvorstadt 1, CH-4051 Basel, Switzerland. She previously served as a Non-Executive Director, Chair of the Audit Committee and member of the Nomination and Governance and Risk Committees of Prudential plc from 2007 until May 2017. The business of Prudential plc is insurance and financial services and the business address is Laurence Pountney Hill, London, EC4R 0HH, United Kingdom. She also previously served as a Non-Executive Director and Audit Committee Chair of Atrium Underwriting Group Limited and Atrium Underwriters Limited from 2007 until 2014. The business of Atrium Underwriting Group Limited and Atrium Underwriters Limited is Lloyds underwriters and the business address is Room 790, Lime Street, London, EC3M 7DQ, United Kingdom. She also previously served as a Non-Executive Director of Arden Holdings Limited from 2007 until 2014. The business of Arden Holdings Limited is insurance and reinsurance and the business address is Union Plaza, 6th Floor, 1 Union Wynd, Aberdeen, AB10 1DQ, United Kingdom. She was formerly the Chief Financial Officer of the Swiss Re Group, and Executive Director and CFO of Northern Rock during the initial phase of its public ownership. Ms. Godbehere is a citizen of Canada and the United Kingdom.

Dr. Marion Helmes (51), Independent Non-Executive Director. Dr. Helmes was appointed as a Non-Executive Director in August 2016. She is a member of the Audit and Nominations Committees. She has been a Supervisory Board member of Uniper SE since 2017. The business of Uniper SE is energy and the business address is E.ON-Platz 1, 40479 Düsseldorf, Germany. She has been a Supervisory Board member and Chairwoman of the Audit Committee of Bilfinger SE since 2016. The business of Bilfinger SE is engineering and the business address is Carl- Reiss-Platz 1-5, Mannheim, 68165, Germany. She has been Vice Chairwoman of the Supervisory Board of ProSieben Sat.1 Media SE since 2014. The business of ProSieben Sat. 1 Media SE is media and the business address is Medienallee 7, 85774, Unterföhring, Germany. She has been a Non-Executive Director of NXP Semiconductors N.V. since 2013. The business of NXP Semiconductors N.V. is electronics and the business address is High Tech Campus 60, P.O. Box 80073, 5600 KA Eindhoven, Netherlands. She was previously Chief Financial Officer of Celesio from 2012 until 2014 and she was speaker of the Management Board of Celesio from 2013 until 2014. The business of Celesio is pharmaceuticals and healthcare and the

business address is Neckartalstrasse 155, 70376 Stuttgart, Germany. She was the Chief Financial Officer of Q-Cells from 2010 until 2011 and of ThyssenKrupp Elevator Technology from 2006 until 2010. She previously served as a member of the Supervisory Board of Fugro Consult GmbH from 2009 until 2014. Dr. Helmes is a citizen of Germany.

Luc Jobin (58), Independent Non-Executive Director. Mr. Jobin was appointed as a Non-Executive Director on July 25, 2017. Mr. Jobin had been an independent director on the RAI board of directors since 2008 and was a member of the Audit and Finance Committee of the RAI board of directors, in each case until completion of the merger. Mr. Jobin is President and Chief Executive Officer of Canadian National Railway Company, a position he has held since 2016, having served as Executive Vice President and Chief Financial Officer since 2009. He was Executive Vice President of Power Corporation of Canada from 2005 to 2009. Mr. Jobin was Chief Executive Officer of Imperial Tobacco Canada, a subsidiary of BAT, from 2003 to 2005 and Executive Vice President and Chief Financial Officer from 1998 to 2003. Mr. Jobin is a citizen of Canada.

Holly Keller Koeppel (59), Independent Non-Executive Director. Ms. Koeppel was appointed as a Non-Executive Director on July 25, 2017. Ms. Koeppel had been an independent director on the RAI board of directors since 2008 until completion of the merger. She was Chair of the Regulatory, Sustainability and Public Policy Committee and a member of the Audit and Finance Committee of the RAI board of directors, in each case until completion of the merger. Ms. Koeppel is a Senior Advisor to Corsair Capital LLC, where she served as Managing Partner and Co-Head of Infrastructure from 2015 until her retirement in 2017. From 2010 to 2015, she served as Co-Head of Citi Infrastructure Investors and prior to 2010 she held financial and executive management roles with American Electric Power Company, Inc. and Consolidated Natural Gas Company. Ms. Koeppel currently holds Non-Executive Director roles at Vesuvius plc and The AES Corporation. Ms. Koeppel is a citizen of the United States.

Savio Kwan, (69), Independent Non-Executive Director. Mr. Kwan was appointed as a Non-Executive Director in January 2014. He is a member of the Nominations and Remuneration Committees. He was the Co-Founder of and has served as the Chief Executive Officer of A&K Consulting Co Ltd since 2005. The business of A&K Consulting Co Ltd is consulting and the business address is 19th Floor, 3, Lockhart Road, Wan Chai, Hong Kong. Mr. Kwan has been a visiting Professor at Henley Business School since 2008. The business of Henley Business School is business education and the business address is University of Reading, Whiteknights, Reading, RG6 6UD, United Kingdom. Mr. Kwan has been a member of the Governing Board of the Alibaba Hong Kong Entrepreneurs Fund since 2015. The business of Alibaba Hong Kong Entrepreneurs fund is an entrepreneur fund and the business address is 26/F Tower One, Times Square, 1 Matheson Street, Causeway Bay, Hong Kong. He was a Non- Executive Director of Alibaba.com Limited from 2008 until 2012. The business of Alibaba.com Limited is online business and the address is 699 Wang Shang Road, Binjiang District, Hangzhou, 310052, China. Mr. Kwan was Chief Operating Officer of Alibaba Group, China's largest internet business from 2001 until 2003. He was an Advisory Board member of York International Corp between 2003 and 2006. Mr. Kwan is a citizen of the United Kingdom.

Dr. Pedro Malan, (74), Independent Non-Executive Director. Dr. Malan was appointed as a Non-Executive Director in February 2015. He is a member of the Audit and Nominations Committees. He has been a member of the advisory panel of Temasek Holdings (Private) Limited since 2012. The business of Temasek Holdings (Private) Limited is a wealth fund and the business address is 60B Orchard Road, #06-18 Tower 2, The Atrium@Orchard, Singapore, 238891. He is a Trustee of the Thomson Reuters Trust Principles, and has been a Director and member, acting as trustee, of Thomson Reuters Founders Share Company Limited since 2011. The business of Thomson Reuters Founders Share Company Limited is media ownership and a trust company, and the business address is 30 South Colonnade, Canary Wharf, London, E14 5EP, United Kingdom. Dr. Malan has been the Chairman of the International Advisory Board of Itaú Unibanco Holding S.A. since 2009. The business of Itaú Unibanco Holding S.A. is banking and the business address is Praça Alfredo Egydio de Souza Aranha, 100, Torre Olavo Setubal, Parque Jabaquara — CEP 04344-902, São Paulo, Brazil. Dr. Malan has been a member of the Board of EDP — Energias do Brasil SA since 2006. The business of EDP — Energias do Brasil SA is energy generation, distribution and commercialization and the business address is Rua Gomes de Carvalho, 1.996, 7th Floor, Vila Olímpia, São Paulo, Brazil. He previously served as a Non-Executive Director of Mills Estruturas e Servicos de Engenharia SA from 2010 until 2016. The business of Mills Estruturas e Servicos de Engenharia SA is engineering services and the business address is Estrada do Guerenguê, 1381 — Taquara, Rio de Janeiro — RJ, Brazil. He served as a Board Member of Souza Cruz from 2010 until 2015. The business of Souza Cruz is tobacco and the business address is Rua Candelária, 66 — Centro, CEP: 20.091-900, Rio de Janeiro — RJ, Brazil. He served as a Trustee of International Financial Reporting Standards Foundation from 2008 until 2013. The business of International Financial Reporting Standards Foundation is financial standards and the business address is 30 Cannon Street, London, EC4M 6XH, United Kingdom. Dr. Malan served as a Non-Executive Director of OGX Petróleo e Gás Participações S.A. ("OGX") from June 2008 to June 2013, when

he resigned. In October 2013, OGX filed a judicial recovery request, a court supervised reorganization proceeding in Brazil, at the Judicial District of Rio de Janeiro State. The business of OGX is oil and gas exploration and production and the business address is Rua do Passeio 56, 10° Andar, Centro, Cep 20021-290, — Rio de Janeiro, Brazil. Dr. Malan served as Non-Executive Director of Via Varejo from 2010 until 2012. The business of Via Varejo is retail and the business address is Rua João Pessoa, nº 83, Centro — São Caetano do Sul, SP, Cep: 09520-010, Brazil. Additionally, Dr. Malan served as the Minister of Finance for Brazil, President of the Central Bank of Brazil and Chief External Debt Negotiator for Brazil. Dr. Malan is a citizen of Brazil.

Lionel L. Nowell, III (62), Independent Non-Executive Director. Mr. Nowell was appointed as a Non-Executive Director on July 25, 2017. Mr. Nowell had been the Lead Independent Director of the RAI board of directors from January 2017, having served as a director since 2007, and was a member of the Compensation and Leadership Development Committee and the Corporate Governance and Nominating Committee of the RAI board of directors, in each case until completion of the merger. Mr. Nowell retired as Senior Vice President and Treasurer of PepsiCo in 2009, where he had held senior financial executive roles since 1999. Prior to PepsiCo, Mr. Nowell was Senior Vice President, Strategy and Business Development at RJR Nabisco, Inc. from 1998 to 1999 and held a variety of senior financial roles at the Pillsbury division of Diageo PLC from 1991 to 1998. He is currently a Non-Executive Director at HD Supply Holdings, American Electric Power Company, Inc. and Bank of America Corporation. Mr. Nowell is a citizen of the United States.

Dimitri Panayotopoulos (65), Independent Non-Executive Director and Chairman of the Remuneration Committee. Mr. Panayotopoulos was appointed as a Non-Executive Director in February 2015. He is the Chairman of the Remuneration Committee and a member of the Nominations Committee. He has been a senior advisor at Boston Consulting Group since 2014. The business of Boston Consulting Group is consulting and the business address is Exchange Place, 31st Floor, Boston, MA, 01209, United States. Mr. Panayotopoulos has been a Non-Executive Director and member of the Compensation Committee of Logitech since 2014. The business of Logitech is technology and the business address is Logitech Europe S.A., EPFL — Quartier de l'Innovation, Daniel Borel Innovation Center, CH — 1015, Lausanne, Switzerland. He was previously Vice Chairman and Advisor to the Chairman and Chief Executive Officer of Procter & Gamble from 2013 until 2014, and was the Vice Chair of the Global Business Units of Procter & Gamble from 2011 until 2013. The business of Procter & Gamble is consumer goods and the business address is General Offices, Central Building, 1st Floor, 1P&G Plaza, Cincinnati, OH, 45202, United States. Mr. Panayotopoulos is a citizen of the United Kingdom.

Kieran Poynter (66), Senior Independent Non-Executive Director and Chairman of the Audit Committee. Mr. Poynter was appointed as a Non-Executive Director in 2010 and as the Senior Independent Director in October 2016. He is the Chairman of the Audit Committee and a member of the Nominations Committee. He has been a Non-Executive Director and Chair of the Audit and Compliance Committee of International Consolidated Airlines Group S.A. since 2010. The business of International Consolidated Airlines Group S.A. is airlines and the business address is CL Camino De La Muñoza, S/N, 28042, Madrid, Spain. He has been Chairman of the Board since 2013 and a member of the Board since 2009 of F&C Asset Management plc, and he also chairs the Nominations, Audit and Compliance and Risk and Remuneration Committees of F&C Asset Management plc. The business of F&C Asset Management plc is asset management and the business address is 6th Floor, Quartermile 4, 7a Nightingale Way, Edinburgh EH3 9EG. He previously held the position of Non-Executive Chairman of the Board of Nomura International plc from 2011 until 2015, and served as a member of the Board from 2009 until 2015. The business of Nomura International plc is banking and the business address is 1 Angel Lane, London, EC4R 3AB, United Kingdom. A Chartered Accountant, he was Chairman and Senior Partner of PricewaterhouseCoopers until 2008 and served on the President's Committee of the Confederation of British Industry between 2000 and 2008 and as member of an advisory committee for the Chancellor of the Exchequer between 2009 and 2010. Mr. Poynter is a citizen of the United Kingdom.

As described above, directors serve in additional roles outside of BAT. From time to time, any such role may give rise to an actual or potential conflict of interest between such director's duties to BAT and his or her duties arising from such other roles. During the last 12 months, a number of conflicts were notified to BAT in accordance with the conflicts of interest procedures. All matters authorized by the BAT board of directors and the Conflicts Committee were recorded in the register of interests maintained by the Company Secretary.

The BAT board of directors' conflicts procedures require that if a director becomes aware that they have an actual or potential conflict of interest, such director is required to notify the BAT Company Secretary. Such conflicts can be authorized by the BAT board of directors or the Conflicts Committee under such procedures, in accordance with the requirements of the UK Companies Act 2006 and the BAT articles of association. Each year, the BAT board of directors considers afresh all previously authorized situational conflicts. Directors are excluded from the quorum and the vote in respect of any matters in which they have an interest. The duties owed by the directors do not give rise to any potential conflict of interest with such directors' private interests and/or other duties.

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

BAT Group Management Board

The BAT Group management board, chaired by the Chief Executive, is responsible for overseeing the implementation of the BAT Group's strategy and policies set by the BAT board of directors, and for creating the framework for the day-to-day operation of the BAT Group's operating subsidiaries. Its other members comprise the Finance Director and 11 senior managers, listed below.

Jack Bowles (54), Regional Director, Asia-Pacific. Mr. Bowles was appointed as Regional Director for Asia-Pacific in January 2013. He was Regional Director, Americas from October 2011 after joining the BAT Group management board originally as Regional Director, Western Europe in October 2009. He joined the BAT Group in 2004, becoming Chairman of British American Tobacco France in 2005 before being appointed Managing Director of British American Tobacco Malaysia in 2007. Mr. Bowles is a citizen of France.

Giovanni Giordano (52), Director, Group Human Resources. Mr. Giordano joined the BAT Group and the BAT Group management board as the BAT Group Human Resources Director in June 2011. Prior to this appointment, his international human resources career included senior roles at Procter & Gamble and Ferrero, where he was Chief Corporate Officer. Mr. Giordano is a citizen of Italy and the United States.

Andrew Gray (52), Director, Marketing. Mr. Gray was appointed as Marketing Director in September 2014. He originally joined the BAT Group management board as Regional Director for Africa and the Middle East in 2008 prior to being appointed Regional Director for EEMEA in January 2011. He has held a number of senior management positions with the BAT Group across South America, Central America, the Caribbean and Malaysia, including President of Souza Cruz in Brazil. Mr. Gray is a citizen of the United Kingdom and Brazil.

Dr. David O'Reilly (51), Group Scientific Director. Dr. O'Reilly joined the BAT Group management board as Group Scientific Director in January 2012. He was previously Head of International Public Health & Scientific Affairs and has held various positions in Group Research & Development, referred to as GR&D, most recently as Head of GR&D. Dr. O'Reilly is a citizen of the United Kingdom.

Naresh Sethi (51), Director, Business Development. Mr. Sethi was appointed Business Development Director in December 2016. He joined the BAT Group management board as Group Business Development Director in January 2012, and became Regional Director of Western Europe from 2013 until 2016. He has held various marketing roles with the BAT Group in Australia, India, Indonesia, West Africa and Japan, where he was Marketing Director and, later, General Manager. Mr. Sethi is a citizen of Australia.

Kingsley Wheaton (44), Managing Director, Next Generation Products. Mr. Wheaton was appointed Managing Director, Next Generation Products in January 2015. Mr. Wheaton joined the BAT Group management board as Deputy Corporate and Regulatory Affairs Director in January 2012, and in June 2012 he was appointed Director, Corporate and Regulatory Affairs. Prior to these appointments, he was Global Brand Manager for Kent and Vogue, and previously also held various marketing roles in the Middle East and West Africa, becoming Marketing Director in Nigeria and Russia and, later, General Manager in Russia. Mr. Wheaton is a citizen of the United Kingdom.

Jerome Abelman (53), Director, Legal & External Affairs and General Counsel. Mr. Abelman joined the BAT Group management board as Group Corporate and Regulatory Affairs Director in January 2015 and as of May 1, 2015, Mr. Abelman took the role of Director, Legal & External Affairs and General Counsel. Prior to his appointment to the Management Board, he was Regional General Counsel, Asia-Pacific from 2010 until 2014, before becoming Assistant General Counsel of Corporate & Commercial from 2014 until December 2014. He has previously held a number of roles in the Legal function and has been with the BAT Group for 14 years. As a director designated for nomination by B&W under the Governance Agreement, Mr. Abelman was a member of the RAI board of directors from February 4, 2016 until the completion of the merger on July 25, 2017. Mr. Abelman is a citizen of the United States.

Alan Davy (53), Director, Operations. Mr. Davy joined the BAT Group management board as Group Operations Director in March 2013. Prior to his present appointment, he was Group Head of Supply Chain from 2010 until 2013, and Area Director of Caribbean and Central America from 2010 until 2012. He joined the BAT Group in 1988 and has held various roles in manufacturing, supply chain and general management. Mr. Davy is a citizen of the United Kingdom.

Tadeu Marroco (51), Regional Director, Western Europe. Mr. Marroco was appointed Western Europe Regional Director in December 2016. He held the position of Group Head of Strategy and Planning, Mergers and Acquisitions in 2014 and joined the BAT Group management board as Business Development Director in

September 2014, a position he held until 2016. He joined the BAT Group in 1992, holding various senior finance positions including Regional Finance Controller, EEMEA and Group Finance Controller, a position he held from 2012 until 2014. Mr. Marroco is a citizen of Brazil.

Ricardo Oberlander (53), Regional Director, Americas. Mr. Oberlander joined the BAT Group management board as Regional Director for the Americas in January 2013 having first joined the BAT Group over 25 years ago. He was previously Global Consumer Director from 2012 until 2013, General Manager in France from 2010 until 2012 and prior to that Regional Marketing Manager for the Americas. As a director designated for nomination by B&W under the Governance Agreement, he joined the RAI board of directors in December 2014 and was a member until the completion of the merger on July 25, 2017. Mr. Oberlander is a citizen of Brazil.

Johan Vandermeulen (49), Regional Director, Eastern Europe, Middle East and Africa. Mr. Vandermeulen joined the BAT Group management board as Regional Director for Eastern Europe, Middle East and Africa in September 2014. He was previously General Manager in Russia, from 2010 until 2014, General Manager in Turkey and Global Brand Director for Kent. He has been with the BAT Group for more than 20 years. Mr. Vandermeulen is a citizen of Belgium.

Debra A. Crew (46), President and CEO of RAI. Ms. Crew joined the BAT Group management board with effect from July 27, 2017, following completion of the merger. Ms. Crew has been President and CEO of RAI since January 2017, having previously served as President and Chief Operating Officer of RJR Tobacco Company. Prior to joining RAI in 2014, Ms. Crew held various management and marketing roles with PepsiCo, Mars, Nestlé and Kraft Foods and served in the U.S. Army. Ms. Crew currently sits on the board of directors of Stanley Black & Decker, Inc. Ms. Crew is a citizen of the United States.

BAT Group Management Board Remuneration for 2016

Individual disclosure of the remuneration paid by BAT to the members of the BAT Group management board (excluding those who also serve as members of the BAT board of directors) is not required in the United Kingdom and BAT does not otherwise publicly disclose this information. In BAT's fiscal year ended December 31, 2016, the aggregate remuneration paid or payable to the members of the BAT Group management board (excluding those who also serve as members of the BAT board of directors) as a group was approximately £28,359,492, which includes: salaries paid during such period (£4,954,451), short-term incentives under the BAT International Executive Incentive Scheme awarded during such period, including amounts deferred under the DSBS, (£8,582,790), long-term incentives under the LTIP awarded during such period (£12,114,744), contributions and accruals by the BAT Group during such period to provide pension, retirement or similar benefits (£2,092,000) and the value of taxable benefits provided during such period (£815,000). In addition, the aggregate value of BAT ordinary shares received by members of the BAT Group management board (excluding those who also serve as members of the BAT board of directors) as a group in settlement of amounts deferred under the DSBS and long-term incentives under the LTIP, in each case, that vested during BAT's fiscal year ended December 31, 2016 was approximately £7,308,088. The aggregate amount set aside by the BAT Group to provide pension, retirement or similar benefits in relation to the members of the BAT board of directors and the members of the BAT Group management board as of December 31, 2016 was £58,884,556.

Indemnification and Advancement of Expenses; Director Liability

Subject to certain exceptions, English law does not permit BAT to indemnify a director against any liability attaching to him or her in connection with any negligence, default, breach of duty or breach of trust in relation to BAT. The exceptions allow BAT to: (1) purchase and maintain director and officer insurance insuring its directors or the directors of an "associated company" (i.e., a company that is a subsidiary of BAT) against any liability attaching in connection with any negligence, default, breach of duty or breach of trust owed to the company of which he or she is a director; (2) provide a qualifying third party indemnity provision which permits BAT to indemnify its directors and directors of an associated company in respect of proceedings brought by third parties (covering both legal costs and the amount of any adverse judgment), except for (a) the legal costs of an unsuccessful defense of criminal proceedings or civil proceedings brought by the company or an associated company, or the legal costs incurred in connection with certain specified applications by the director for relief where the court refuses to grant the relief, (b) fines imposed in criminal proceedings, and (c) penalties imposed by regulatory bodies; (3) loan funds to a director to meet expenditure incurred defending civil and criminal proceedings against him or her (even if the action is brought by the company itself), or expenditure incurred applying for certain specified relief, subject to the requirement that the loan must be on terms that it is repaid if the defense or application for relief is unsuccessful; and (4) provide a qualifying pension scheme indemnity provision, which allows the company to indemnify a director of a company that is a trustee of an occupational pension scheme against liability incurred in connection with such director's activities as a trustee of the scheme (subject to certain exceptions).

Under the BAT articles of association, subject to the UK Companies Act 2006, BAT may do any or all of the following:

- indemnify to any extent any person who is or was a director, or a director of any associated company, directly or indirectly (including by funding any expenditure incurred or to be incurred by him or her) against any loss or liability, whether in connection with any proven or alleged negligence, default, breach of duty or breach of trust by him or her or otherwise, in relation to BAT or any associated company;
- indemnify to any extent any person who is or was a director of an associated company that is a trustee of an occupational pension scheme, directly or indirectly (including by funding any expenditure incurred or to be incurred by him or her) against any liability incurred by him or her in connection with the company's activities as trustee of an occupational pension scheme; and
- purchase and maintain insurance for any person who is or was a director, or a director of any associated company, against any loss or liability or any expenditure he or she may incur, whether in connection with any proven or alleged negligence, default, breach of duty or breach of trust by him or her or otherwise, in relation to BAT or any associated company.

SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

Security Ownership of BAT Ordinary Shares

As of July 31, 2017, BAT had a total of 2,456,153,138 ordinary shares in issue, listed on the LSE and the JSE. 376,664,374 of these ordinary shares are listed as BAT ADSs on the NYSE.

As of July 31, 2017, there were 40,437 record holders of BAT ordinary shares listed on the LSE (including Citibank as the depositary bank for the BAT ADSs) and 2,213,301,073 of such BAT ordinary shares outstanding. As of such date, to BAT's knowledge, 302 record holders, representing 0.04% of the BAT ordinary shares listed on the LSE, had a registered address in the United States. As of July 31, 2017, there were 924 record holders of BAT ordinary shares listed on the JSE (including PLC Nominees (Proprietary) Limited as the nominee for the dematerialized BAT ordinary shares listed on the JSE) and 242,852,065 of such BAT ordinary shares outstanding. As of such date, to BAT's knowledge, no record holders of the BAT ordinary shares listed on the JSE had a registered address in the United States. As of July 31, 2017, based on information received from Citibank, there were 10,351 record holders of BAT ADSs and 376,664,374 BAT ADSs outstanding. As of such date, based on information received from Citibank, 10,296 record holders, representing 99.96% of BAT ADSs representing BAT ordinary shares, had a registered address in the United States.

The tables below set forth the beneficial ownership of certain BAT shareholders. Percentage of ownership is based on 2,293,507,548 BAT ordinary shares outstanding (excluding 162,645,590 treasury shares) as of July 31, 2017.

Security Ownership of BAT Principal Shareholders

The table below presents, to the knowledge of BAT's management on the basis of notification received under the UK Disclosure Guidance and Transparency Rules, referred to as the DTRs, information regarding the total amount of BAT shares directly or indirectly owned by BAT's major shareholders, including, in accordance with applicable UK regulations, each shareholder that is known to BAT to have voting rights of 3% or more as of July 31, 2017.

Brokers or other nominees may hold BAT ordinary shares in "street name" for customers who are the beneficial owners of the shares. As a result, BAT may not be aware of each person or group of affiliated persons who own more than 3% of BAT ordinary shares. BAT's major shareholders do not have different voting rights from BAT's other shareholders.

Name of Beneficial Owner	Number of Ordinary Shares	Percentage of Issued Share Capital[1]
BlackRock, Inc.	132,891,526	5.79
Reinet Investments S.C.A.	76,518,264	3.34
The Capital Group Companies, Inc.	94,321,111	4.11

(1) The percentage of issued share capital excludes treasury shares.

To the knowledge of BAT's management, none of the above shareholders hold voting rights which are different from those held by BAT's other shareholders and there are no shareholdings that carry special rights relating to control of BAT.

Significant Changes in Ownership

In accordance with the DTRs, share transfers by major shareholders of greater than 1% must be reported to BAT. The following table sets out the notifications received by BAT during the past three years to the best of BAT's knowledge.

Name of Beneficial Owner	Date of notification	Nature of threshold crossed/reached as a result of share transfers	Number of ordinary shares immediately following notification	Percentage of issued share capital immediately following notification
The Capital Group Companies, Inc.	August 25, 2015	Above 4%	75,240,878	4.04
The Capital Group Companies, Inc.	March 3, 2016	Above 5%	94,321,111	5.06

Security Ownership of BAT Directors and the BAT Group management board

The following table presents information regarding the total amount of BAT ordinary shares beneficially owned (outright, by their family or by connected persons) by each current director of BAT, each member of the BAT Group management board and all directors and the BAT Group management board as a group, as of July 31, 2017. Unless otherwise indicated, the address for each director and member of the BAT Group management board listed is: c/o British American Tobacco p.l.c., Globe House, 4 Temple Place, London WC2R 2PG, United Kingdom. The address for Jack Bowles is 16th Floor, 2 IFC, 8 Finance Street, Central, Hong Kong. The address for Debra A. Crew is 401 North Main Street, Winston-Salem, NC 27101, United States of America.

	Number of Ordinary Shares	Percentage of Class[8]
BAT Directors		
Richard Burrows	15,000	0.0007
Nicandro Durante[1][2]	254,703	0.0111
Ben Stevens[1]	84,340	0.0037
Sue Farr	—	—
Ann Godbehere[3]	3,100	0.0001
Marion Helmes	4,500	0.0002
Luc Jobin[3]	45,236	0.0020
Holly Keller Koeppel[3]	8,416	0.0004
Savio Kwan	6,217	0.0003
Pedro Malan	—	—
Lionel L. Nowell, III[3]	17,436	0.0008
Dimitri Panayotopoulos	3,300	0.0001
Kieran Poynter	5,000	0.0002
BAT Group management board		
Jerome Abelman[4]	35,992	0.0016
Jack Bowles[4]	114,278	0.0050
Debra A. Crew[5]	42,200	0.0018
Alan Davy[4]	43,276	0.0019
Giovanni Giordano[4][6][7]	30,583	0.0013
Andrew Gray[4]	47,750	0.0021
Tadeu Marroco[4]	12,986	0.0006
David O'Reilly[4]	20,251	0.0009
Ricardo Oberlander[4]	47,667	0.0021
Naresh Sethi[4][6]	48,763	0.0021
Johan Vandermeulen[4]	6,264	0.0003
Kingsley Wheaton[4]	7,235	0.0003
All BAT Directors and BAT Group management board as a group (25 Persons)	904,493	0.0394

Notes:

(1) The number of BAT ordinary shares beneficially owned by the Executive Directors include BAT ordinary shares awarded and required to be held for a period of at least three years in a UK-based trust under the SIP. BAT ordinary shares cannot be sold or transferred out of the trust until the end of the three-year holding period. The amounts above include the following BAT ordinary shares held in the trust under the SIP:

(a) 2,047 BAT ordinary shares for Mr. Durante, of which 401 have been held for less than three years; and

(b) 524 BAT ordinary shares for Mr. Stevens, of which 267 have been held for less than three years. In all cases, the beneficial owner of BAT ordinary shares under the SIP may direct the trust to exercise its voting rights in accordance with his instructions. See footnote (5) to the table below under the heading "— *Outstanding Share-based Awards and Options-based Awards of BAT Directors and the BAT Group Management Board*" for additional details regarding the SIP and the BAT ordinary shares held thereunder.

(2) The number of BAT ordinary shares beneficially owned by Mr. Durante includes 591 options granted under the Sharesave Scheme that have vested and may be exercised within 60 days of July 31, 2017. Each option is convertible into one BAT ordinary share upon exercise. See footnote (2) to the table below under the heading "— *Outstanding Share-based Awards and Options-based Awards of BAT Directors and the BAT Group Management Board*" for additional details regarding the Sharesave Scheme.

(3) The BAT ordinary shares beneficially owned by Ms. Godbehere, Mr. Jobin, Ms. Koeppel and Mr. Nowell are represented by BAT ADSs, each of which represents one BAT ordinary share.

(4) The number of BAT ordinary shares beneficially owned by the members of the BAT Group management board include BAT ordinary shares awarded and required to be held for a period of at least three years in a UK-based trust under the SIP. BAT ordinary shares cannot be sold or transferred out of the trust until the end of the three-year holding period. The amounts above include the following BAT ordinary shares held in the trust under the SIP: (a) 311 BAT ordinary shares for Mr. Abelman, of which 217 have been held for less than

three years; (b) 475 BAT ordinary shares for Mr. Bowles, of which 235 have been held for less than three years; (c) 489 BAT ordinary shares for Mr. Davy, of which 243 have been held for less than three years; (d) 708 BAT ordinary shares for Mr. Giordano, of which 260 have been held for less than three years; (e) 757 BAT ordinary shares for Mr. Gray, of which 271 have been held for less than three years; (f) 440 BAT ordinary shares for Mr. Marroco, of which 230 have been held for less than three years; (g) 1,553 BAT ordinary shares for Mr. O'Reilly, of which 355 have been held for less than three years; (h) 377 BAT ordinary shares for Mr. Oberlander, of which 231 have been held for less than three years; (i) 1,217 BAT ordinary shares for Mr. Sethi, of which 316 have been held for less than three years; (j) 311 BAT ordinary shares for Mr. Vandermeulen, of which 180 have been held for less than three years; and (k) 617 BAT ordinary shares for Mr. Wheaton, of which 256 have been held for less than three years. In all cases, the beneficial owner of BAT ordinary shares under the SIP may direct the trust to exercise its voting rights in accordance with his instructions. See footnote (5) to the table below under the heading "— *Outstanding Share-based Awards and Options-based Awards of BAT Directors and the BAT Group Management Board*" for additional details regarding the SIP and the BAT ordinary shares held thereunder.

(5) The BAT ordinary shares beneficially owned by Ms. Crew are represented by BAT ADSs, each of which represents one BAT ordinary share.

(6) The number of BAT ordinary shares beneficially owned by the members of the BAT Group management board include the following number of options granted under the LTIP and the Sharesave Scheme that have vested and may be exercised within 60 days of July 31, 2017: (a) 236 options under the Sharesave Scheme for Mr. Giordano and (b) 14,648 options under the LTIP and 346 options under the Sharesave Scheme for Mr. Sethi. Each option is convertible into one BAT ordinary share upon exercise. See footnotes (1) and (2) to the table below under the heading "— *Outstanding Share-based Awards and Options-based Awards of BAT Directors and the BAT Group Management Board*" for additional details regarding the LTIP and the Sharesave Scheme, respectively.

(7) 8,000 BAT ordinary shares held by Mr. Giordano are represented by BAT ADSs, each of which represents one BAT ordinary share.

(8) The information in this column is based on 2,293,507,548 BAT ordinary shares outstanding (excluding treasury shares) as of July 31, 2017. Any securities not outstanding subject to options, warrants, rights or conversion privileges that give the beneficial owner the right to acquire the securities within 60 days are deemed to be outstanding for the purpose of computing the percentage of outstanding securities of the class owned by such person but are not deemed to be outstanding for the purpose of computing the percentage of the class by any other person.

Outstanding Share-based Awards and Options-based Awards of BAT Directors and the BAT Group Management Board

The following table presents information regarding the options and the restricted share awards held by the BAT Directors and the BAT Group management board as of July 31, 2017. The following BAT Directors (being the Chairman and the Non-Executive Directors) have not been granted share-based Awards or Options-based Awards over BAT ordinary shares: Mr. Burrows, Ms. Farr, Ms. Godbehere, Dr. Helmes, Mr. Jobin, Ms. Koeppel, Mr. Kwan, Dr. Malan, Mr. Nowell, Mr. Panayotopoulos and Mr. Poynter.

	Number of Options Held	Date of Grant/Award	Options Exercise Price £	Market Price at Date of Grant of Option £	Number of Shares Awarded	Exercisable (LTIP/Sharesave) Vesting (DSBS/SIP/RAI LTI)
BAT Directors						
Nicandro Durante						
LTIP[1]	127,448	27-Mar-15	0.00	36.25	—	27 Mar 2018-26 Mar 2025
	140,529	12-May-16	0.00	42.34	—	12 May 2021-11 May 2026
	114,181	27-Mar-17	0.00	52.11	—	27 Mar 2022-26 Mar 2027
Sharesave[2]	591	28-Mar-12	25.36	31.70	—	1 May 2017-31 Oct 2017
	543	26-Aug-14	27.87	34.83	—	1 Oct 2019-31 Mar 2020
	369	24-Mar-17	40.56	50.70	—	1 May 2022-31 Oct 2022
Total Options[3]	**383,661**					
DSBS[4]	—	27-Mar-15	—	—	19,419	27-Mar-18
	—	29-Mar-16	—	—	29,690	29-Mar-19
	—	27-Mar-17	—	—	28,545	27-Mar-20
SIP[5]	—	30-Sep-14	—	—	21	30-Sep-17
	—	1-Apr-15	—	—	52	1-Apr-18
	—	8-May-15	—	—	44	8-May-18
	—	30-Sep-15	—	—	23	30-Sep-18
	—	1-Apr-16	—	—	88	1-Apr-19
	—	9-May-16	—	—	43	9-May-19
	—	28-Sep-16	—	—	20	28-Sep-19
	—	3-Apr-17	—	—	67	3-Apr-20
	—	4-May-17	—	—	43	4-May-20
Total Restricted Share Awards[6]					**78,055**	

	Number of Options Held	Date of Grant/Award	Options Exercise Price £	Market Price at Date of Grant of Option £	Number of Shares Awarded	Exercisable (LTIP/Sharesave) Vesting (DSBS/SIP/RAI LTI)
Ben Stevens						
LTIP[1]	69,641	27-Mar-15	0.00	36.25	—	27 Mar 2018-26 Mar 2025
	71,669	12-May-16	0.00	42.34	—	12 May 2021-11 May 2026
	58,232	27-Mar-17	0.00	52.11	—	27 Mar 2022-26 Mar 2027
Sharesave[2]	543	26-Aug-14	27.87	34.83	—	1 Oct 2019-31 Mar 2020
	495	23-Mar-15	30.26	37.82	—	1 May 2020-31 Oct 2020
Total Options[3]	**200,580**					
DSBS[4]	—	27-Mar-15	—	—	12,732	27-Mar-18
	—	29-Mar-16	—	—	19,468	29-Mar-19
	—	27-Mar-17	—	—	15,805	27-Mar-20
SIP[5]	—	30-Sep-14	—	—	7	30-Sep-17
	—	1-Apr-15	—	—	52	1-Apr-18
	—	8-May-15	—	—	15	8-May-18
	—	30-Sep-15	—	—	7	30-Sep-18
	—	1-Apr-16	—	—	88	1-Apr-19
	—	9-May-16	—	—	13	9-May-19
	—	28-Sep-16	—	—	6	28-Sep-19
	—	3-Apr-17	—	—	67	3-Apr-20
	—	4-May-17	—	—	12	4-May-20
Total Restricted Share Awards[6]					**48,272**	
BAT Group management board						
Jerome Abelman						
LTIP[1]	23,448	27-Mar-15	0.00	36.25	—	27 Mar 2018-26 Mar 2025
	22,732	12-May-16	0.00	42.34	—	12 May 2019-11 May 2026
	19,583	27-Mar-17	0.00	52.11	—	27 Mar 2020-26 Mar 2027
Sharesave[2]	991	23-Mar-15	30.26	37.82	—	1 May 2020-31 Oct 2020
Total Options[3]	**66,754**					
DSBS[4]	—	27-Mar-15	—	—	1,706	27-Mar-18
	—	29-Mar-16	—	—	8,164	29-Mar-19
	—	27-Mar-17	—	—	6,658	27-Mar-20
SIP[5]	—	1-Apr-15	—	—	52	1-Apr-18
	—	1-Apr-16	—	—	88	1-Apr-19
	—	9-May-16	—	—	3	9-May-19
	—	28-Sep-16	—	—	2	28-Sep-19
	—	3-Apr-17	—	—	67	3-Apr-20
	—	4-May-17	—	—	5	4-May-20
Total Restricted Share Awards[6]					**16,745**	
Jack Bowles						
LTIP[1]	35,517	27-Mar-15	0.00	36.25	—	27 Mar 2018-26 Mar 2025
	31,943	12-May-16	0.00	42.34	—	12 May 2019-11 May 2026
	26,463	27-Mar-17	0.00	52.11	—	27 Mar 2020-26 Mar 2027
Total Options[3]	**93,923**					
DSBS[4]	—	27-Mar-15	—	—	7,359	27-Mar-18
	—	29-Mar-16	—	—	11,473	29-Mar-19
	—	27-Mar-17	—	—	8,997	27-Mar-20
SIP[5]	—	30-Sep-14	—	—	3	30-Sep-17
	—	1-Apr-15	—	—	52	1-Apr-18
	—	8-May-15	—	—	7	8-May-18
	—	30-Sep-15	—	—	3	30-Sep-18
	—	1-Apr-16	—	—	88	1-Apr-19

	Number of Options Held	Date of Grant/Award	Options Exercise Price £	Market Price at Date of Grant of Option £	Number of Shares Awarded	Exercisable (LTIP/Sharesave) Vesting (DSBS/SIP/RAI LTI)
	—	9-May-16	—	—	6	9-May-19
	—	28-Sep-16	—	—	3	28-Sep-19
	—	3-Apr-17	—	—	67	3-Apr-20
	—	4-May-17	—	—	6	4-May-20
Total Restricted Share Awards[6]					**28,064**	
Debra A. Crew						
RAI LTI[7]	—	1-Mar-17	—	—	**103,485**	1-Mar-20
Alan Davy						
LTIP[1]	25,862	27-Mar-15	0.00	36.25	—	27 Mar 2018-26 Mar 2025
	23,027	12-May-16	0.00	42.34	—	12 May 2019-11 May 2026
	19,099	27-Mar-17	0.00	52.11	—	27 Mar 2020-26 Mar 2027
Sharesave[2]	543	26-Aug-14	27.87	34.83	—	1 Oct 2019-31 Mar 2020
	221	24-Mar-17	40.56	50.70	—	1 May 2020-31 Oct 2020
Total Options[3]	**68,752**					
DSBS[4]	—	27-Mar-15	—	—	5,358	27-Mar-18
	—	29-Mar-16	—	—	8,270	29-Mar-19
	—	27-Mar-17	—	—	6,493	27-Mar-20
SIP[5]	—	30-Sep-14	—	—	3	30-Sep-17
	—	1-Apr-15	—	—	52	1-Apr-18
	—	8-May-15	—	—	7	8-May-18
	—	30-Sep-15	—	—	5	30-Sep-18
	—	1-Apr-16	—	—	88	1-Apr-19
	—	9-May-16	—	—	7	9-May-19
	—	28-Sep-16	—	—	4	28-Sep-19
	—	3-Apr-17	—	—	67	3-Apr-20
	—	4-May-17	—	—	10	4-May-20
Total Restricted Share Awards[6]					**20,364**	
Giovanni Giordano						
LTIP[1]	34,137	27-Mar-15	0.00	36.25	—	27 Mar 2018-26 Mar 2025
	30,113	12-May-16	0.00	42.34	—	12 May 2019-11 May 2026
	24,966	27-Mar-17	0.00	52.11	—	27 Mar 2020-26 Mar 2027
Sharesave[2]	236	28-Mar-12	25.36	31.70	—	1 May 2017-31 Oct 2017
	475	23-Mar-15	30.26	37.82	—	1 May 2018-31 Oct 2018
	88	24-Mar-17	40.56	50.70	—	1 May 2020-31 Oct 2020
Total Options[3]	**90,015**					
DSBS[4]	—	27-Mar-15	—	—	7,073	27-Mar-18
	—	29-Mar-16	—	—	10,815	29-Mar-19
	—	27-Mar-17	—	—	8,488	27-Mar-20
SIP[5]	—	30-Sep-14	—	—	5	30-Sep-17
	—	1-Apr-15	—	—	52	1-Apr-18
	—	8-May-15	—	—	10	8-May-18
	—	30-Sep-15	—	—	6	30-Sep-18
	—	1-Apr-16	—	—	88	1-Apr-19
	—	9-May-16	—	—	12	9-May-19
	—	28-Sep-16	—	—	6	28-Sep-19
	—	3-Apr-17	—	—	67	3-Apr-20
	—	4-May-17	—	—	14	4-May-20
Total Restricted ShareAwards[6]					**26,636**	

	Number of Options Held	Date of Grant/Award	Options Exercise Price £	Market Price at Date of Grant of Option £	Number of Shares Awarded	Exercisable (LTIP/Sharesave) Vesting (DSBS/SIP/RAI LTI)
Andrew Gray						
LTIP[(1)]	37,241	27-Mar-15	0.00	36.25	—	27 Mar 2018-26 Mar 2025
	32,829	12-May-16	0.00	42.34	—	12 May 2019-11 May 2026
	27,197	27-Mar-17	0.00	52.11	—	27 Mar 2020-26 Mar 2027
Sharesave[(2)]	576	28-Mar-14	26.00	32.50	—	1 May 2019-31 Oct 2019
	543	26-Aug-14	27.87	34.83	—	1 Oct 2019-31 Mar 2020
Total Options[(3)]	**98,386**					
DSBS[(4)]	—	27-Mar-15	—	—	7,716	27-Mar-18
	—	29-Mar-16	—	—	11,791	29-Mar-19
	—	27-Mar-17	—	—	9,247	27-Mar-20
SIP[(5)]	—	30-Sep-14	—	—	7	30-Sep-17
	—	1-Apr-15	—	—	52	1-Apr-18
	—	8-May-15	—	—	13	8-May-18
	—	30-Sep-15	—	—	8	30-Sep-18
	—	1-Apr-16	—	—	88	1-Apr-19
	—	9-May-16	—	—	14	9-May-19
	—	28-Sep-16	—	—	7	28-Sep-19
	—	3-Apr-17	—	—	67	3-Apr-20
	—	4-May-17	—	—	15	4-May-20
Total Restricted ShareAwards[(6)]					**29,025**	
Tadeu Marroco						
LTIP[(1)]	24,137	27-Mar-15	0.00	36.25	—	27 Mar 2018-26 Mar 2025
	21,315	12-May-16	0.00	42.34	—	12 May 2019-11 May 2026
	21,109	27-Mar-17	0.00	52.11	—	27 Mar 2020-26 Mar 2027
Sharesave[(2)]	534	26-Mar-13	28.07	35.08	—	1 May 2018-31 Oct 2018
	495	23-Mar-15	30.26	37.82	—	1 May 2020-31 Oct 2020
Total Options[(3)]	**67,590**					
DSBS[(4)]	—	27-Mar-15	—	—	3,825	27-Mar-18
	—	29-Mar-16	—	—	7,655	29-Mar-19
	—	27-Mar-17	—	—	7,177	27-Mar-20
SIP[(5)]	—	30-Sep-14	—	—	1	30-Sep-17
	—	1-Apr-15	—	—	52	1-Apr-18
	—	8-May-15	—	—	3	8-May-18
	—	30-Sep-15	—	—	3	30-Sep-18
	—	1-Apr-16	—	—	88	1-Apr-19
	—	9-May-16	—	—	5	9-May-19
	—	28-Sep-16	—	—	3	28-Sep-19
	—	3-Apr-17	—	—	67	3-Apr-20
	—	4-May-17	—	—	8	4-May-20
Total Restricted ShareAwards[(6)]					**18,887**	
David O'Reilly						
LTIP[(1)]	24,137	27-Mar-15	0.00	36.25	—	27 Mar 2018-26 Mar 2025
	21,315	12-May-16	0.00	42.34	—	12 May 2019-11 May 2026
	17,674	27-Mar-17	0.00	52.11	—	27 Mar 2020-26 Mar 2027
Total Options[(3)]	**63,126**					
DSBS[(4)]	—	27-Mar-15	—	—	5,001	27-Mar-18
	—	29-Mar-16	—	—	7,655	29-Mar-19
	—	27-Mar-17	—	—	6,009	27-Mar-20
SIP[(5)]	—	30-Sep-14	—	—	16	30-Sep-17
	—	1-Apr-15	—	—	52	1-Apr-18
	—	8-May-15	—	—	34	8-May-18

	Number of Options Held	Date of Grant/Award	Options Exercise Price £	Market Price at Date of Grant of Option £	Number of Shares Awarded	Exercisable (LTIP/Sharesave) Vesting (DSBS/SIP/RAI LTI)
	—	30-Sep-15	—	—	18	30-Sep-18
	—	1-Apr-16	—	—	88	1-Apr-19
	—	9-May-16	—	—	33	9-May-19
	—	28-Sep-16	—	—	15	28-Sep-19
	—	3-Apr-17	—	—	67	3-Apr-20
	—	4-May-17	—	—	32	4-May-20
Total Restricted Share Awards[6]					**19,020**	
Ricardo Oberlander						
LTIP[1]	29,482	27-Mar-15	0.00	36.25	—	27 Mar 2018-26 Mar 2025
	26,511	12-May-16	0.00	42.34	—	12 May 2019-11 May 2026
	21,996	27-Mar-17	0.00	52.11	—	27 Mar 2020-26 Mar 2027
Sharesave[2]	534	26-Mar-13	28.07	35.08	—	1 May 2018-31 Oct 2018
	495	23-Mar-15	30.26	37.82	—	1 May 2020-31 Oct 2020
Total Options[3]	**79,018**					
DSBS[4]	—	27-Mar-15	—	—	6,108	27-Mar-18
	—	29-Mar-16	—	—	9,522	29-Mar-19
	—	27-Mar-17	—	—	7,478	27-Mar-20
SIP[5]	—	30-Sep-14	—	—	2	30-Sep-17
	—	1-Apr-15	—	—	52	1-Apr-18
	—	8-May-15	—	—	5	8-May-18
	—	30-Sep-15	—	—	2	30-Sep-18
	—	1-Apr-16	—	—	88	1-Apr-19
	—	9-May-16	—	—	5	9-May-19
	—	28-Sep-16	—	—	3	28-Sep-19
	—	3-Apr-17	—	—	67	3-Apr-20
	—	4-May-17	—	—	7	4-May-20
Total Restricted Share Awards[6]					**23,339**	
Naresh Sethi						
LTIP[1]	31,844	28-Mar-14	0.00	32.58	—	28 Mar 2017-27 Mar 2024
	29,482	27-Mar-15	0.00	36.25	—	27 Mar 2018-26 Mar 2025
	26,009	12-May-16	0.00	42.34	—	12 May 2019-11 May 2026
	21,545	27-Mar-17	0.00	52.11	—	27 Mar 2020-26 Mar 2027
Sharesave[2]	346	28-Mar-14	26.00	32.50	—	1 May 2017-31 Oct 2017
	322	26-Aug-14	27.87	34.83	—	1 Oct 2017-31 Mar 2018
	369	24-Mar-17	40.56	50.70	—	1 May 2022-31 Oct 2022
Total Options[3]	**109,917**					
DSBS[4]	—	27-Mar-15	—	—	6,108	27-Mar-18
	—	29-Mar-16	—	—	9,341	29-Mar-19
	—	27-Mar-17	—	—	7,325	27-Mar-20
SIP[5]	—	30-Sep-14	—	—	12	30-Sep-17
	—	1-Apr-15	—	—	52	1-Apr-18
	—	8-May-15	—	—	24	8-May-18
	—	30-Sep-15	—	—	13	30-Sep-18
	—	1-Apr-16	—	—	88	1-Apr-19
	—	9-May-16	—	—	24	9-May-19
	—	28-Sep-16	—	—	11	28-Sep-19
	—	3-Apr-17	—	—	67	3-Apr-20
	—	4-May-17	—	—	25	4-May-20
Total Restricted Share Awards[6]					**23,090**	

	Number of Options Held	Date of Grant/Award	Options Exercise Price £	Market Price at Date of Grant of Option £	Number of Shares Awarded	Exercisable (LTIP/Sharesave) Vesting (DSBS/SIP/RAI LTI)
Johan Vandermeulen						
LTIP(1)	28,620	27-Mar-15	0.00	36.25	—	27 Mar 2018-26 Mar 2025
	25,094	12-May-16	0.00	42.34	—	12 May 2019-11 May 2026
	21,195	27-Mar-17	0.00	52.11	—	27 Mar 2020-26 Mar 2027
Sharesave(2)	991	23-Mar-15	30.26	37.82	—	1 May 2020-31 Oct 2020
Total Options(3)	**75,900**					
DSBS(4)	—	27-Mar-15	—	—	5,892	27-Mar-18
	—	29-Mar-16	—	—	9,013	29-Mar-19
	—	27-Mar-17	—	—	7,206	27-Mar-20
SIP(5)	—	1-Apr-15	—	—	17	1-Apr 18
	—	1-Apr-16	—	—	88	1-Apr-19
	—	9-May-16	—	—	2	9-May-19
	—	28-Sep-16	—	—	2	28-Sep-19
	—	3-Apr-17	—	—	67	3-Apr-20
	—	4-May-17	—	—	4	4-May-20
Total Restricted Share Awards(6)					**22,291**	
Kingsley Wheaton						
LTIP(1)	29,482	27-Mar-15	0.00	36.25	—	27 Mar 2018-26 Mar 2025
	25,242	12-May-16	0.00	42.34	—	12 May 2019-11 May 2026
	21,382	27-Mar-17	0.00	52.11	—	27 Mar 2020-26 Mar 2027
Total Options(3)	**76,106**					
DSBS(4)	—	27-Mar-15	—	—	5,158	27-Mar-18
	—	29-Mar-16	—	—	9,066	29-Mar-19
	—	27-Mar-17	—	—	7,270	27-Mar-20
SIP(5)	—	30-Sep-14	—	—	5	30-Sep-17
	—	1-Apr-15	—	—	52	1-Apr-18
	—	8-May-15	—	—	10	8-May-18
	—	30-Sep-15	—	—	6	30-Sep-18
	—	1-Apr-16	—	—	88	1-Apr-19
	—	9-May-16	—	—	11	9-May-19
	—	28-Sep-16	—	—	5	28-Sep-19
	—	3-Apr-17	—	—	67	3-Apr-20
	—	4-May-17	—	—	12	4-May-20
Total Restricted Share Awards(6)					**21,750**	

Notes:

Options

(1) LTIP: Grants or awards of BAT ordinary shares under the LTIP are for nil consideration. The number of options shown is the maximum that may be exercised subject to the completion of the applicable performance period and conditions under the rules of the LTIP. The number of options which may vest and become exercisable may be less than the numbers of BAT ordinary shares shown in the table.

(2) Sharesave Scheme: Grants of options under the Sharesave Scheme are: (a) normally granted at a discount of 20% to the market price of BAT ordinary shares at the time of invitation, as permitted by the rules of the Sharesave Scheme; and (b) are exercisable at the end of a three-year or five-year savings contract up to a monthly limit of £500.

(3) Each of the LTIP and Sharesave Scheme contains provisions which permit the BAT board of directors or a duly authorized committee of the BAT board of directors to establish further plans for the benefit of overseas employees based on the relevant share plan but modified as necessary or desirable to take account of overseas tax, exchange control or securities laws. Any new BAT ordinary shares issued under such plans would not count towards any applicable plan limits under the LTIP or the Sharesave Scheme.

Restricted Share Awards

(4) DSBS: Awards of deferred shares are made through the DSBS and comprise free BAT ordinary shares normally held in trust for three years and no further performance conditions apply in that period. The BAT ordinary shares carry no rights to vote in that period.

(5) SIP: The SIP is an all-employee plan which includes the SRS under which eligible employees receive an award of BAT ordinary shares, referred to as Free Shares, in April of each year in which the plan operates in respect of performance in the previous financial year. The Free Shares are held in a UK-based trust from the date of the award for a minimum period of three years. During that time the SIP participant is entitled to receive dividends on those BAT ordinary shares which are re-invested by such trust to buy further BAT ordinary shares, referred to as Dividend Shares, on behalf of the SIP participant. The Dividend Shares are also held in the trust from the date of acquisition for a minimum period of three years. During the three-year holding periods, the SIP participant may not remove the Free Shares or the Dividend Shares from the trust, but may direct the trust to exercise its voting rights in accordance with his or her instructions. In addition to the Free Shares and Dividend Shares, participants in the SIP are also eligible to purchase additional BAT ordinary shares from their pre-tax salary up to an annual statutory limit, referred to as Partnership Shares. The SIP also provides that BAT has the right to offer additional BAT ordinary shares to a participant at no cost for each Partnership Share the participant purchases, at a ratio of two such BAT ordinary shares for each Partnership Share purchased, referred to as Matching Shares. BAT does not currently provide any Matching Shares.

(6) BAT has established similar plans to the SIP for non-UK employees and specific plans for employees in Germany, Belgium and The Netherlands. Each of these plans has been modified to take account of overseas tax, exchange control and securities laws.

(7) RAI LTI: Awards of RAI LTI are former RAI equity awards that were assumed by BAT upon the completion of the merger, at which time they were converted into awards that, when earned, will be settled for BAT ADSs. The RAI LTI awards are subject to a three-year performance period, and may vest from between 0% to 150% of the target value depending on the achievement of the applicable performance criteria. The number of RAI LTI awards shown in the table above represent 100% of target performance.

THE MERGER

On January 16, 2017, BAT entered into an Agreement and Plan of Merger with RAI, BATUS Holdings Inc., a Delaware Corporation and indirect, wholly owned subsidiary of BAT, and Flight Acquisition Corporation, a North Carolina corporation and an indirect, wholly owned subsidiary of BAT, as it and the plan of merger contained therein were amended as of June 8, 2017, pursuant to which, upon the terms and subject to the conditions thereof, on July 25, 2017, Merger Sub was merged with and into RAI, with RAI surviving as an indirect, wholly owned subsidiary of BAT.

In evaluating the merger, the BAT Group considered a variety of factors with respect to the merger, including the following strategic factors (not necessarily in order of relative importance):

Strategic Factors Considered by the BAT Group:

- *Enhanced Geographic Coverage*: The BAT Group considered the enhanced geographic coverage across emerging and developed markets expected to result from the merger. The BAT Group has a significant presence in emerging markets across South America, Africa, the Middle East and Asia. Over the last five years, revenue per pack in these markets has grown at more than twice the rate compared to developed markets. With generally low cigarette pack prices and expectations of continued growth in consumer disposable income over the long term, the future profit growth opportunity remains strong. While the United States is characterized as a developed market, direct access to the U.S. market strengthens the BAT Group's opportunity for long-term profitable growth. The United States is the world's largest tobacco profit pool (excluding China) and over the last five years has grown revenue per pack at a faster rate than other developed markets. Long-term growth prospects are underpinned by affordable pack prices, relatively high disposable incomes and a growing market for next generation products.
- *Combined Portfolio of Global Brands*: The BAT Group considered the combined portfolio of strong, growing global brands of both the BAT Group and the RAI Group, bringing together ownership of Newport, Kent and Pall Mall, and in particular that the unified ownership of these brands would allow the BAT Group to leverage consistent global positioning and shared resources. The BAT Group also considered the fact that the RAI Group was well positioned with the second largest cigarette market share in the U.S. market, with three out of the four top-selling cigarette brands.
- *Global Next Generation Product Business*: The BAT Group considered the potential of the combined business as a global company in the fast growing next generation product category, with an opportunity to leverage scale and insights across the largest and fastest growing next generation product markets and categories. The BAT Group is one of the largest international companies in the vapor market outside of the United States and China, having successfully launched a portfolio of products in the five largest vapor markets in Europe and established significant market share in the United Kingdom and Poland, based on the BAT Group's internal estimates.
- *Cost Savings and Synergies*: The BAT Group considered the future shareholder value expected to be created by the merger through cost synergies. These synergies are expected to be primarily achieved by leveraging the scale of the combined business, integrating corporate functions and eliminating redundant spending using the BAT Group's target operating model principles and policies and delivering other efficiencies in manufacturing and supply chain. Cost synergies exist in the following main areas — procurement, manufacturing, product development and corporate costs of the combined company. Although the BAT Group expects that cost savings will result from the merger, there can be no assurance that any particular amount of such savings or synergies will be achieved or that they will be achieved in the expected time frame. There will be one-off costs associated with delivering these synergies. The annual cost synergies and anticipated one-off expenditure reflect both the beneficial elements and the relevant costs of achieving those synergies.
- *Growth Prospects*: The BAT Group has a successful track record of developing strong brands and growing market share through a consistent focus on consumer insights, product quality and innovation, enabling it to build on RAI's existing share growth momentum. The BAT Group believes that ownership of RAI and access to the U.S. market will further support the BAT Group's commitment to long-term profitable growth through consistent revenue growth. Further, the BAT Group believes that the merger gives the BAT Group ownership of what will be a significant proportion of the BAT Group cash flows and provides more balanced exposure to foreign exchange.

Although the above discussion sets forth the principal strategic factors considered by the BAT Group in its consideration of the merger, it is not intended to be exhaustive.

Upon the completion of the merger on July 25, 2017, each issued and outstanding share of RAI common stock was automatically converted into the right to receive the merger consideration, consisting of (1) a number of BAT ADSs representing 0.5260 of a BAT ordinary share plus (2) $29.44 in cash, without interest, and otherwise subject to adjustments to prevent dilution in accordance with the merger agreement, other than:

- such shares that were owned by BAT or any of its subsidiaries immediately prior to the completion of the merger (which ceased to be outstanding and were automatically canceled upon the completion of the merger); and
- such shares that were held by a holder who has properly asserted (and not lost or effectively withdrawn) his, her or its appraisal rights for such shares in accordance with Article 13 of the NCBCA (which were not converted into and do not represent the right to receive the merger consideration, but instead will only be entitled to receive such consideration as may be determined to be due with respect to such shares pursuant to and subject to the requirements of Article 13 of the NCBCA and in accordance with the merger agreement).

Borrowings under the acquisition facility were used to finance the cash portion of the merger consideration, and a portion of such borrowings will be repaid with the proceeds of the offering of the Notes. Total cash consideration was $24.4 billion, and following the merger, former RAI shareholders (other than BAT and its subsidiaries) owned approximately 19% of BAT's share capital. See "*Use of Proceeds*" and "*Capitalization and Indebtedness*".

RELATED PARTY TRANSACTIONS

The BAT Group has a number of transactions and relationships with related parties, all of which are undertaken in the normal course of business. Details of these are set out below (transactions with CTBAT are not included in these disclosures as it is a joint operation).

Transactions with Associates

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 £221 million (compared to £145 million in 2015). The BAT Group's share of dividends from associates, included in other net income in the table below, was £1,024 million (compared to £640 million in 2015).

Transactions	Year Ended December 31, 2016	Year Ended December 31, 2015
	(£ million)	
– revenue	370	38
– purchases	(298)	(270)
– other net income	1,023	639
– Amounts receivable at December 31	270	190
– Amounts payable at December 31	(2)	(20)

Key Management Personnel

BAT's key management personnel consist of the members of the BAT board of directors and the members of the BAT Group management board. No such person had any material interest during 2016, 2015 or 2014 in a contract of significance (other than a service contract) with the BAT Group. The term key management personnel in this context includes the respective members of their households.

	Year Ended December 31, 2016	Year Ended December 31, 2015
	(£ million)	
The total compensation for key management personnel, including directors, was:		
– salaries and other short-term employee benefits	18	20
– post-employment benefits	3	4
– share-based payments	12	11
Total	33	35

Contributions to the British American Tobacco UK Pension Fund

Contributions to the British American Tobacco UK Pension Fund are secured by a charge over the BAT Group head office (Globe House, 4 Temple Place, London WC2R 2PG, United Kingdom) up to a maximum of £150 million.

Additional Information Regarding Transactions with RAI

In July 2004, the U.S. assets, liabilities and operations, other than certain specified assets and liabilities, of BAT's wholly owned subsidiary, B&W, were combined with RJR Tobacco Company. RAI was previously formed as a new holding company for these combined businesses, and B&W acquired beneficial ownership of approximately 42% of RAI's outstanding common stock.

In connection with the B&W business combination, RAI, B&W and BAT entered into the Governance Agreement, which sets forth the parties' agreement regarding various aspects of the governance of RAI, including B&W's right to designate for nomination to the RAI board of directors five directors, at least three of whom were required to be independent directors and two of whom could be executive officers of BAT or any of its subsidiaries. The Governance Agreement terminated upon the closing of the merger.

RAI paid BAT an aggregate of $904,148 during 2016 in consideration for the services of Mr. Abelman and Mr. Oberlander as directors of RAI. In addition, at the direction of BAT, RAI paid John Daly the sum of $45,596 during 2016, in consideration for his service as a director of RAI.

RAI paid BAT an aggregate of $369,004 during 2015 in consideration for the services of Mr. Oberlander as a director of RAI. In addition, at the direction of BAT, RAI paid Mr. Daly the sum of $369,004 during 2015, in consideration for his service as a director of RAI after his retirement from BAT.

RAI paid BAT an aggregate of $388,101 during 2014 in consideration for the services of Mr. Oberlander and Mr. Daly (for his service prior to his retirement from BAT in April 2014) and Neil R. Withington as directors

of RAI. In addition, at the direction of BAT, RAI paid Mr. Daly the sum of $224,771 during 2014, in consideration for his service as a director of RAI after his retirement from BAT.

In connection with the B&W business combination, RJR Tobacco Company agreed to indemnify B&W and its affiliates for, among other things, certain liabilities arising out of the U.S. cigarette and tobacco business of B&W, including certain litigation liabilities. Any indemnification obligations B&W or RJR Tobacco Company have to the other would rank equally in right of payment with all of such party's existing and future senior unsecured debt. The indemnities are of perpetual duration and will not be affected by the merger. As a result of this indemnity, RJR Tobacco Company has assumed the defense of pending B&W-specific tobacco-related litigation, has paid the judgments and costs related to certain pre-B&W business combination tobacco-related litigation of B&W, and has posted bonds on behalf of B&W, where necessary, in connection with cases decided since the B&W business combination. In 2014, 2015 and 2016, RJR Tobacco Company paid no reimbursements to the BAT Group in connection with this indemnity.

In connection with the B&W business combination, RJR Tobacco Company entered into contract manufacturing agreements with two subsidiaries of BAT — BATUS Japan, Inc., referred to as BATUSJ, and B.A.T. (U.K. & Export) Limited, referred to as BATUKE.

Under the 2004 agreement with BATUKE, RJR Tobacco Company was appointed the exclusive U.S. manufacturer of all American-blend cigarettes which any BAT Customer (as defined in the agreement) chooses to manufacture in the United States, its territories and military installations. There were no sales by RJR Tobacco Company to BATUKE under such agreement during 2016, 2015 and 2014.

Under the 2004 agreement with BATUSJ, as superseded and amended through May 2015, RJR Tobacco Company was BATUSJ's exclusive manufacturer of all of BATUSJ's requirements for certain American-blend cigarettes intended to be sold and distributed in Japan. In May 2015, RJR Tobacco Company, BATUKE and BATUSJ entered into a restated and revised American-blend cigarette manufacturing agreement, referred to as the 2015 Agreement, modifying the prior contract manufacturing agreement between RJR Tobacco Company and BATUSJ. Generally, under the 2015 Agreement, BATUKE agreed to assume BATUSJ's obligations under the prior agreement. On January 4, 2016, RJR Tobacco Company received written notice from BATUKE, in accordance with the terms of the 2015 Agreement, terminating the 2015 Agreement effective January 5, 2019. In July 2016, RJR Tobacco Company and BATUKE further amended the 2015 Agreement. Under such amendment, among other things, RJR Tobacco Company agreed to (1) permit an early transition of the cigarette production covered by the agreement to BAT Group facilities over several months beginning in the fourth quarter of 2016, and (2) provide contingent manufacturing capacity to BATUKE through December 31, 2018. In addition, under such amendment, BATUKE agreed to make certain payments to RJR Tobacco Company, including an aggregate payment of $89.6 million, payable in two installments — a payment of $7.4 million received in September 2016 and a payment of $82.2 million received in March 2017, and to purchase related leaf tobacco both held by and committed to be purchased by RJR Tobacco Company. At March 31, 2017, under the terms of the amendment, BATUKE had a requirement to purchase $62.8 million in leaf tobacco, none of which (including that portion of the purchase price that was paid by BATUKE in the first quarter of 2017) was recorded as sales in the RAI Group's unaudited consolidated financial statements, but will be recognized as sales when the leaf tobacco is shipped to BATUKE. Sales by RJR Tobacco Company to the BAT Group pursuant to the cigarette manufacturing agreements described in this paragraph during the first six months of 2017 and the years 2016, 2015 and 2014 were $66.0 million, $188.2 million, $229.3 million and $254.4 million, respectively. Net sales to the BAT Group, primarily cigarettes, represented approximately 1% and 2% of RAI's total net sales during the six months ended June 30, 2017 and 2016, respectively.

During the years 2016, 2015 and 2014, the BAT Group purchased tobacco leaf from RJR Tobacco Company in the amount of $38.1 million, $29.2 million and $56.8 million, respectively. Also, at December 31, 2016, the BAT Group had agreed to purchase additional tobacco leaf from RJR Tobacco Company in the amount of $25.5 million, none of which (including that portion of the purchase price that was paid by the BAT Group in 2016) was recorded as sales in RAI Group's consolidated financial statements, but will be recognized as sales when the product is shipped to the BAT Group. In addition, during the years 2016, 2015 and 2014, the BAT Group purchased from RJR Tobacco Company expanded tobacco and reconstituted tobacco, and other tobacco products, in the amount of $18,000, $54,000 and $97,000, respectively.

RJR Tobacco Company and a member of the BAT Group are also parties to a technology sharing and development services agreement, which was entered into in July 2004. Pursuant to this agreement, each party may license or otherwise transfer rights to the other in its respective technologies, and may pursue joint technology projects with the other party. Each party or its respective affiliates also may provide certain contract services to the other party or its affiliates. Unless earlier terminated as provided therein, the technology sharing and development services agreement automatically renews for additional one-year periods each December 31

unless one of the parties provides a notice of non-renewal at least 12 months prior to the December 31 date on which termination is to become effective. During the years 2016, 2015 and 2014, RJR Tobacco Company billed the BAT Group $1.3 million, $3 million and $3.7 million and the BAT Group billed RJR Tobacco Company approximately $53,000, $31,000 and $254,000, respectively, pursuant to such agreement. In the years 2016, 2015 and 2014, RJR Tobacco Company recorded royalty income of $85,000, $30,000 and $7.0 million, respectively, for the use of certain capsule technology by the BAT Group.

RJR Tobacco Company also purchases tobacco leaf and cigarettes from the BAT Group, and pays royalties to the BAT Group relating to the sale by RJR Tobacco Company of certain cigarette brands, including the Dunhill brand, which RJR Tobacco Company licenses from the BAT Group, and the State Express 555 brand, which RJR Tobacco Company licenses from CTBAT, a joint venture between the BAT Group and CNTC. The parties entered into the agreements evidencing such arrangements, which have various expiration dates, following the consummation of the B&W business combination. During the years 2016, 2015 and 2014, RJR Tobacco Company recognized transactions with the BAT Group of $14.6 million, $11.3 million and $22.5 million, respectively, pursuant to the foregoing arrangements. During the years 2016, 2015 and 2014, RJR Tobacco Company also paid the BAT Group $6.1 million, $6.0 million and $2.3 million, respectively, for other purchases. In addition, as of the end of 2016, RJR Tobacco Company had $6.6 million in accounts payable to the BAT Group under such arrangements. During the years 2016, 2015 and 2014, American Snuff Company recorded leaf purchases from the BAT Group of $1.1 million, $1.6 million and $3.5 million, respectively, and in 2015, SFRTI recorded cigarette purchases from the BAT Group of $19.6 million. In January 2016, SFRTI paid a fee of $6.0 million to the BAT Group to amend a contract manufacturing agreement.

In December 2015, RJR Tobacco Company and Nicoventures Holdings Limited, a subsidiary of BAT, signed a definitive vapor technology-sharing and licensing agreement, providing a framework for collaboration and mutual cross-licensing of vapor product technologies through 2022. In 2016, RJR Tobacco Company recorded income of $171,000 associated with trade marketing services related to such agreement. In the first six months of 2017, RJR Tobacco Company did not record income associated with trade marketing services related to such agreement.

From time to time, each of RJR Tobacco Company and the BAT Group has seconded certain of its employees to the other or a member of such entity's group of companies in connection with particular assignments. During their service with the other entity or a member of such entity's group of companies, the seconded employees continue to be paid by the original employer and participate in employee benefit plans sponsored by such employer. Each of RJR Tobacco Company and the BAT Group reimburses members of the other party's group of companies for certain costs of the seconded employees' compensation and benefits during the secondment period. For 2015 and 2014, RJR Tobacco Company billed the BAT Group $6,000 and $7,000, respectively, in connection with such secondment arrangements. In 2016, RJR Tobacco Company did not bill the BAT Group for any costs pursuant to such secondment arrangements.

In connection with the share repurchase program authorized by the RAI board of directors in November 2011, RAI and B&W entered into an agreement, pursuant to which B&W agreed to participate in a new RAI share repurchase program on a basis approximately proportionate with B&W's 42% ownership of RAI's equity. During 2014, RAI repurchased 2,887,715 shares of RAI common stock from B&W for the aggregate amount of $155 million under such agreement. Such repurchase program concluded in May 2014.

In November 2011, RAI, BAT and B&W entered into Amendment No. 3 to the Governance Agreement pursuant to which, among other things, RAI agreed that if RAI issued shares of RAI common stock or any other RAI equity security to certain designated persons, including its directors, executive officers or employees (such as upon the vesting of performance shares or restricted stock units), then RAI would repurchase a number of shares of RAI common stock equal to the number of shares of RAI common stock issued so that the number of outstanding shares of RAI common stock is not increased, and the beneficial ownership interest of the BAT Group is not decreased, by such issuance after taking into account the repurchases. During 2014, RAI repurchased and canceled 946,252 shares of RAI common stock for the aggregate amount of $47.7 million pursuant to the Governance Agreement. During 2015, RAI repurchased and canceled 1,820,453 shares of RAI common stock for the aggregate amount of $82.0 million pursuant to the Governance Agreement. During 2016, RAI repurchased and canceled 1,817,846 shares of RAI common stock for the aggregate amount of $93 million pursuant to the Governance Agreement. During the first six months of 2017, in accordance with the Governance Agreement, at a cost of $81 million, RAI repurchased 1,258,907 shares of RAI common stock in open-market transactions. Subsequent to June 30, 2017, and through July 13, 2017, RAI repurchased and cancelled an additional 113,160 shares of RAI common stock for $7 million in accordance with the Governance Agreement.

In February 2017, RAI and BAT entered into a letter agreement pursuant to which BAT waived the requirement that the RAI share repurchases required to be made by RAI pursuant to Amendment No. 3 to the

governance agreement be made within the time period set forth in that amendment, and permitted RAI to make the repurchases in a manner that qualifies for the affirmative defense and safe harbor provided by Rules 10b5-1 and 10b-18 under the Exchange Act, respectively. Pursuant to this letter agreement, BAT also waived compliance with the general prohibition on repurchases contained in the merger agreement to permit RAI to make these repurchases.

In July 2014, RAI and BAT entered into a Subscription and Support Agreement, referred to as the subscription agreement, in connection with the transactions related to RAI's acquisition of Lorillard. In June 2015, concurrently with the completion of such acquisition and pursuant to the subscription agreement, BAT, indirectly (through Louisville) purchased, at a price of approximately $4.7 billion in the aggregate, 77,680,259 shares of RAI common stock (prior to giving effect to RAI's two-for-one split of its common stock effected in August 2015), which was sufficient for the BAT Group to collectively maintain their approximate 42% beneficial ownership in RAI. In addition, BAT caused all shares of RAI common stock beneficially owned by the BAT Group to be voted in favor of the issuance of the additional shares of RAI common stock contemplated by both the RAI-Lorillard merger agreement and the subscription agreement.

In July 2016, B&W, Louisville and RAI entered into a new share repurchase agreement, pursuant to which B&W and Louisville agreed to participate in RAI's share repurchase program announced in July 2016 on a basis approximately proportionate with the 42% ownership of RAI's equity by B&W and Louisville. During 2016, RAI repurchased 660,385 shares of RAI common stock from Louisville for the aggregate amount of $32 million. Subject to certain exceptions, the merger agreement placed restrictions on RAI's ability to repurchase its common stock. As a result, RAI did not repurchase any shares under the share repurchase program during the first six months of 2017 and did not make future repurchases under the share repurchase program from June 30, 2017 to the closing of the merger.

See notes 11 and 27 to the BAT Group's consolidated financial statements included in this Offering Memorandum.

On July 25, 2017, the merger was completed and RAI has become an indirect, wholly owned subsidiary of BAT.

Related Party Transactions of RAI

Lisa J. Caldwell, currently Executive Vice President and Chief Human Resources Officer of RAI and RAISC, is married to Alan L. Caldwell, who was the Director — Corporate and Civic Engagement of RAISC until his retirement in May 2016. During 2016, Mr. Caldwell earned approximately $110,457 in salary and bonus, and vested in a long-term incentive award valued at approximately $163,543.

Nancy H. Hawley, currently Executive Vice President — Operations of RJR Tobacco Company, is married to Ray W. Hawley, who is currently Senior Manager — Payroll for RAISC. During 2016, Mr. Hawley earned approximately $181,798 in salary and bonus.

See also "— *Additional Information Regarding Transactions with RAI*".

DESCRIPTION OF THE NOTES AND THE GUARANTEES

The following is a summary of the material provisions of the Indenture (as described below) and the Notes. We urge you to read the Notes and the Indenture in their entirety because the Notes and the Indenture, not this summary, define your rights as a holder of the Notes. A copy of the Indenture is available upon request to BAT at the address indicated under the section entitled "Available Information and Reports to Noteholders". Any capitalized term used herein but not defined shall have the meaning assigned to such term in the Indenture or under "— Certain Definitions".

The Indenture will not be qualified under the U.S. Trust Indenture Act of 1939, as amended ("TIA"), except upon effectiveness of a registration statement with respect to the Notes. See "Registration Rights Agreement". By its terms, however, the Indenture will incorporate certain provisions of the TIA and, if an Exchange Offer is consummated or a resale Shelf Registration Statement is effective, will become subject to the TIA. The following summary does not purport to be complete and is subject to, and is qualified in its entirety by reference to, all of the provisions of the Indenture and those terms made a part of each such Indenture by reference to the TIA as in effect on the date of the closing of the offering of the Notes.

General

The $2,250,000,000 principal amount of 2.297% Notes due 2020 (the "2020 Fixed Rate Notes"), the $2,250,000,000 principal amount of 2.764% Notes due 2022 (the "2022 Fixed Rate Notes"), the $2,500,000,000 principal amount of 3.222% Notes due 2024 (the "2024 Fixed Rate Notes"), the $3,500,000,000 principal amount of 3.557% Notes due 2027 (the "2027 Fixed Rate Notes"), the $2,500,000,000 principal amount of 4.390% Notes due 2037 (the "2037 Fixed Rate Notes"), the $2,500,000,000 principal amount of 4.540% Notes due 2047 (the "2047 Fixed Rate Notes" and, together with the 2020 Fixed Rate Notes, the 2022 Fixed Rate Notes, the 2024 Fixed Rate Notes, the 2027 Fixed Rate Notes and the 2037 Fixed Rate Notes, the "Fixed Rate Notes"), the $1,000,000,000 principal amount of floating rate notes due 2020 (the "2020 Floating Rate Notes") and the $750,000,000 principal amount of floating rate notes due 2022 (the "2022 Floating Rate Notes", and together with the 2020 Floating Rate Notes, the "Floating Rate Notes") will be issued by B.A.T Capital Corporation ("BATCAP" or the "Issuer"). Together, the Fixed Rate Notes and the Floating Rate Notes are referred to as the "Notes".

In this Offering Memorandum, we refer to each series of the Fixed Rate Notes and Floating Rate Notes as a "series" of Notes.

The 2020 Fixed Rate Notes will mature on August 14, 2020. The 2022 Fixed Rate Notes will mature on August 15, 2022. The 2024 Fixed Rate Notes will mature on August 15, 2024. The 2027 Fixed Rate Notes will mature on August 15, 2027. The 2037 Fixed Rate Notes will mature on August 15, 2037. The 2047 Fixed Rate Notes will mature on August 15, 2047. The 2020 Floating Rate Notes will mature on August 14, 2020. The 2022 Floating Rate Notes will mature on August 15, 2022.

The Notes will be issued in registered form and treated as eight separate series of debt securities under an indenture to be dated as of August 15, 2017 (the "Indenture"). The Indenture will be by and among BATCAP, as Issuer, British American Tobacco p.l.c. (the "Parent Guarantor"), B.A.T. International Finance p.l.c. ("BATIF"), British American Tobacco Holdings (The Netherlands) B.V. ("BATHTN"), B.A.T. Netherlands Finance B.V. ("BATNF" and, together with BATHTN, the "Dutch Guarantors"), and, unless its guarantee is released in accordance with the BATIF Indenture, Reynolds American Inc. ("RAI"), each as a guarantor, Wilmington Trust, National Association, as trustee (the "Trustee"), and Citibank, N.A., London Branch as paying agent, registrar, transfer agent and calculation agent, and in each such several capacities as the "Paying Agent", "Transfer Agent", "Registrar" and "Calculation Agent").

Each entity that provides a guarantee in respect of the Notes is referred to herein as a "Guarantor". In this "Description of the Notes and the Guarantees", the terms "holder", "Noteholder" and other similar terms refer to a "registered holder" of Notes, and not to a beneficial owner of a book-entry interest in any Notes.

For so long as any Notes remain outstanding and are "restricted securities" within the meaning of Rule 144(a)(3) under the Securities Act, the Issuer will, during any period in which neither it nor any Guarantor is subject to Section 13 or 15(d) of the Exchange Act, or exempt from reporting pursuant to Rule 12g3-2(b) under the Exchange Act, make available to any registered holder of Notes (or any beneficial owner of a book-entry interest in such Notes designated by the registered holder thereof) in connection with any sale thereof and to any prospective purchaser of Notes or a book-entry interest in Notes designated by such holder, in each case upon request of such holder, the information specified in, and meeting the requirements of, Rule 144A(d)(4) under the Securities Act. As of the date of this Offering Memorandum, the Parent Guarantor is subject to the periodic reporting requirements of the Exchange Act.

Principal, Maturity and Interest

The obligations of the Issuer under the Notes and Indenture will be fully and unconditionally guaranteed on a senior and unsecured basis by each of the Parent Guarantor, the Dutch Guarantors, BATIF and, on the issue date, RAI.

The Notes are initially issuable in the following aggregate principal amounts not to be exceeded, with maturity dates as follows:

Series of Notes	*Initial aggregate principal amount*	*Maturity date*
2020 Fixed Rate Notes	$2,250,000,000	August 14, 2020
2022 Fixed Rate Notes	$2,250,000,000	August 15, 2022
2024 Fixed Rate Notes	$2,500,000,000	August 15, 2024
2027 Fixed Rate Notes	$3,500,000,000	August 15, 2027
2037 Fixed Rate Notes	$2,500,000,000	August 15, 2037
2047 Fixed Rate Notes	$2,500,000,000	August 15, 2047
2020 Floating Rate Notes	$1,000,000,000	August 14, 2020
2022 Floating Rate Notes	$ 750,000,000	August 15, 2022

Interest

Fixed Rate Notes

The Fixed Rate Notes will bear interest per annum and have maturity dates as follows:

Series of Fixed Rate Notes	*Interest rate per annum*	*Maturity date*
2020 Fixed Rate Notes	2.297%	August 14, 2020
2022 Fixed Rate Notes	2.764%	August 15, 2022
2024 Fixed Rate Notes	3.222%	August 15, 2024
2027 Fixed Rate Notes	3.557%	August 15, 2027
2037 Fixed Rate Notes	4.390%	August 15, 2037
2047 Fixed Rate Notes	4.540%	August 15, 2047

The 2020 Fixed Rate Notes will bear interest from the date of the initial issuance of such Notes or from the most recent interest payment date to which interest has been paid or provided for, payable semi-annually in arrear on February 14 and August 14 of each year, commencing on February 14, 2018 (each, a "2020 Interest Payment Date"). The 2022 Fixed Rate Notes, the 2024 Fixed Rate Notes, the 2027 Fixed Rate Notes, the 2037 Fixed Rate Notes and the 2047 Fixed Rate Notes will bear interest from the date of the initial issuance of such Notes or from the most recent interest payment date to which interest has been paid or provided for, payable semi-annually in arrear on February 15 and August 15 of each year, commencing on February 15, 2018 (each, together with the 2020 Interest Payment Dates, an "Interest Payment Date") until their respective maturity date, unless previously purchased or redeemed by BATCAP, to the person in whose name any 2020 Fixed Rate Note, 2022 Fixed Rate Note, 2024 Fixed Rate Note, 2027 Fixed Rate Note, 2037 Fixed Rate Note or 2047 Fixed Rate Note, as applicable, is registered at the close of business on the 15th calendar day preceding each Interest Payment Date, whether or not such day is a Business Day (each, a "Record Date") notwithstanding any transfer or exchange of such Notes subsequent to the Record Date and prior to such Interest Payment Date, except that, if and to the extent BATCAP shall default in the payment of the interest due on such Interest Payment Date, and the applicable grace period shall have expired, such defaulted interest may at the option of BATCAP be paid to the persons in whose names the outstanding Notes are registered at the close of business on a subsequent Record Date (which shall not be less than five Business Days prior to the date of payment of such defaulted interest) established by notice sent by or on behalf of the Issuer to the holders (which term means registered holders) of the 2020 Fixed Rate Notes, 2022 Fixed Rate Notes, 2024 Fixed Rate Notes, 2027 Fixed Rate Notes, 2037 Fixed Rate Notes or 2047 Fixed Rate Notes, as applicable, not less than 15 days preceding such subsequent Record Date. Interest will be computed on the basis of a 360-day year consisting of twelve 30-day months or in the case of an incomplete month, the number of days elapsed. If the date on which any interest payment or principal payment is to be made is not a Business Day, such payment will be made on the next day which is a Business Day, without any further interest or other amounts being paid or payable in connection therewith. A "Business Day" refers to any day which is not, in London or New York City, or any other place of payment, a Saturday, Sunday, legal holiday or a day on which banking institutions are authorized or obligated by law or regulation to close.

Floating Rate Notes

Interest will be payable on the 2020 Floating Rate Notes quarterly in arrear on February 14, May 14, August 14 and November 14 of each year, commencing on November 14, 2017. Interest on the 2022 Floating Rate Notes will be payable quarterly in arrear on February 15, May 15, August 15 and November 15 of each year, commencing on November 15, 2017. Interest will be paid to the person in whose name such Note is registered at the close of business on the second Business Day that precedes the related interest payment date. The 2020 Floating Rate Notes will bear interest at a rate per annum equal to LIBOR (as defined below) plus 0.59% which will be reset as described below. The 2022 Floating Rate Notes will bear interest at a rate per annum equal to LIBOR (as defined below) plus 0.88% which will be reset as described below.

If any interest payment date (other than a redemption date or other maturity date) for the Floating Rate Notes would fall on a day that is not a Business Day, the interest payment date will be postponed to the next succeeding business day, except that if that Business Day falls in the next succeeding calendar month, the interest payment date will be the immediately preceding Business Day, in each case with interest accruing to but excluding the date of payment. If a redemption date or other maturity date for the 2020 Floating Rate Notes or the 2022 Floating Rate Notes would fall on a day that is not a Business Day, the payment of interest and principal will be made on the next succeeding Business Day, and no interest will accrue or be payable unless the Issuer fails to make payment on such next succeeding Business Day.

The initial rate of interest on the 2020 Floating Rate Notes and the 2022 Floating Rate Notes will be determined by the Calculation Agent on August 11, 2017. The rate of interest on the 2020 Floating Rate Notes will be reset quarterly on February 14, May 14, August 14 and November 14 of each year, commencing on November 14, 2017 (collectively, the "2020 Interest Reset Dates" and each, a "2020 Interest Reset Date"). The rate of interest on the 2022 Floating Rate Notes will be reset quarterly on February 15, May 15, August 15 and November 15 of each year, commencing on November 15, 2017 (collectively, the "2022 Interest Reset Dates" and each, a "2022 Interest Reset Date" and, together with the 2020 Interest Reset Dates, the "Interest Reset Dates" and each, an "Interest Reset Date"). If any Interest Reset Date would fall on a day that is not a Business Day, the Interest Reset Date will be postponed to the next succeeding Business Day, except that if that Business Day falls in the next succeeding calendar month, the Interest Reset Date will be the immediately preceding Business Day.

The Calculation Agent for the 2020 Floating Rate Notes and the 2022 Floating Rate Notes will be the Paying Agent, or its successor appointed by the Issuer. The Calculation Agent will determine the initial interest rate for the Floating Rate Notes by reference to LIBOR on the second London banking day preceding the issue date and the interest rate for each Interest Reset Date by reference to LIBOR on the second London banking day preceding the applicable Interest Reset Date, each of which is referred to herein as an "Interest Determination Date".

Promptly upon such determination, the Calculation Agent will notify the Issuer and the Trustee of the new interest rate. Upon the request of the holder of any Floating Rate Note, the Calculation Agent will provide the interest rate then in effect and, if determined, the interest rate that will become effective on the next Interest Reset Date.

"London banking day" means any day on which dealings in U.S. dollars are transacted in the London interbank market. "LIBOR" will be determined by the Calculation Agent in accordance with the following provisions:

- With respect to any Interest Determination Date, LIBOR will be the rate (expressed as a percentage per annum) for deposits in U.S. dollars having a maturity of three months commencing on the related Interest Reset Date that appears on Reuters Page LIBOR01 as of 11:00 a.m. (London time) on that Interest Determination Date. If no such rate appears, then LIBOR, in respect of that Interest Determination Date will be determined in accordance with the following provisions.
- With respect to an Interest Determination Date on which no rate appears on Reuters Page LIBOR01, the Calculation Agent will request the principal London offices of each of four major reference banks in the London interbank market (which may include affiliates of the initial purchasers), as selected by the Issuer, to provide its offered quotation (expressed as a percentage per annum) for deposits in U.S. dollars for the period of three months, commencing on the related Interest Reset Date, to prime banks in the London interbank market at approximately 11:00 a.m. (London time) on that Interest Determination Date and in a principal amount that is representative for a single transaction in U.S. dollars in that market at that time. If at least two quotations are provided, then LIBOR on that Interest Determination Date will be the arithmetic mean of those quotations.

- If fewer than two quotations are provided, then LIBOR on the Interest Determination Date will be the arithmetic mean of the rates quoted at approximately 11:00 a.m. (New York City time) on the Interest Determination Date by three major banks in New York City (which may include affiliates of the initial purchasers) selected by the Issuer for loans in U.S. dollars to leading European banks, for a period of three months, commencing on the related Interest Reset Date, and in a principal amount that is representative for a single transaction in U.S. dollars in that market at that time. If at least two such rates are so provided, LIBOR on the Interest Determination Date will be the arithmetic mean of such rates.
- If fewer than two such rates are so provided, LIBOR on the Interest Determination Date will be LIBOR in effect with respect to the immediately preceding Interest Determination Date. "Reuters Page LIBOR01" means the display that appears on Reuters (or any successor service) on page LIBOR01 (or any page as may replace such page on such service) for the purpose of displaying London interbank offered rates of major banks for U.S. dollars.

Interest on the 2020 Floating Rate Notes and the 2022 Floating Rate Notes will be calculated on the basis of a 360-day year and the actual number of days elapsed.

All percentages resulting from any calculation of any interest rate for the Floating Rate Notes will be rounded, if necessary, to the nearest one hundred thousandth of a percentage point, with five one-millionths of a percentage point rounded upward (e.g., 5.876545% (or .05876545) would be rounded to 5.87655% (or .0587655)), and all dollar amounts would be rounded to the nearest cent with one-half cent being rounded upward.

The interest rate on the 2020 Floating Rate Notes and the 2022 Floating Rate Notes will in no event be higher than the maximum rate permitted by applicable law and in no event be less than 0.00%.

All calculations made by the Calculation Agent for the purposes of calculating interest on the 2020 Floating Rate Notes and the 2022 Floating Rate Notes will be conclusive and binding on the holders and the Issuer, absent manifest error.

Form and Denomination

The Notes will be issued in fully registered form and only in denominations of $2,000 and integral multiples of $1,000 in excess thereof. The Notes will be issued initially as Global Notes.

Further Issues

The aggregate principal amount of Notes issuable under the Indenture is unlimited. The Issuer may, from time to time, without notice to or the consent of the holders of the Notes, "reopen" any series of the Notes and create and issue additional notes having identical terms and conditions as the 2020 Fixed Rate Notes, the 2022 Fixed Rate Notes, the 2024 Fixed Rate Notes, the 2027 Fixed Rate Notes, the 2037 Fixed Rate Notes, the 2047 Fixed Rate Notes, the 2020 Floating Rate Notes and the 2022 Floating Rate Notes, as the case may be (or in all respects except for the issue date, issue price, the payment of interest accruing prior to the issue date of such additional notes and/or the first payment of interest following the issue date of such additional notes) so that the additional notes are consolidated and form a single series of Notes with the Notes, as the case may be (a "Further Issue"), provided that if the additional notes are not fungible with the Notes for United States federal income tax purposes, the additional notes will have separate CUSIPs, ISINs, or other identifying numbers.

Status of the Notes and Guarantees

The Notes will be unsecured and unsubordinated obligations of the Issuer and will rank *pari passu* in right of payment among themselves and with all other direct, unsecured and unsubordinated obligations of the Issuer (except those obligations preferred by statute or operation of law). Each Guarantor will fully and unconditionally guarantee, on a senior, unsecured basis, the due and punctual payment (and not collectability) of the principal of and interest on the Notes (and the payment of additional amounts described under "*— Payment of Additional Amounts*" below) and other obligations under the Indenture when and as the same shall become due and payable, whether at stated maturity, by declaration of acceleration, call for redemption or otherwise. Each Guarantee will be an unsecured and unsubordinated obligation of the respective Guarantor and will rank *pari passu* in right of payment with all other direct, unsecured and unsubordinated obligations of such Guarantor (except those obligations preferred by statute or operation of law). The Issuer and each Guarantor will be subject to a negative pledge with respect to certain types of indebtedness, which are discussed in "*— Covenants of the Issuer and the Guarantors — Negative Pledge*" below.

Release

The Indenture will provide that, without the consent of the Trustee or the Noteholders, a Guarantor that is a subsidiary of the Parent Guarantor (a "Subsidiary Guarantor"), other than BATIF and the Dutch Guarantors, will automatically and unconditionally be released from all obligations under its Guarantee, and such Guarantee shall thereupon terminate and be discharged and of no further force or effect, in the event that (1) its guarantee of all then outstanding notes issued under the EMTN Programme is released or (2) at substantially the same time its Guarantee of the Notes is terminated, the Subsidiary Guarantor is released from all obligations in respect of indebtedness for borrowed money for which such Subsidiary Guarantor is an obligor (as a guarantor or borrower). For purposes of this paragraph, the amount of a Subsidiary Guarantor's indebtedness for borrowed money shall not include (A) the Notes issued pursuant to the Indenture, (B) any other debt the terms of which permit the termination of such Subsidiary Guarantor's guarantee of such debt under similar circumstances, as long as such Subsidiary Guarantor's obligations in respect of such other debt are terminated at substantially the same time as its guarantee of the Notes, (C) any debt that is being refinanced at substantially the same time that the guarantee of the Notes is being released, provided that any obligations of the relevant Subsidiary Guarantor in respect of the debt that is incurred in the refinancing shall be included in the calculation of the relevant Subsidiary Guarantor's indebtedness for borrowed money and (D) for the avoidance of doubt, any debt in respect of which such Subsidiary Guarantor is an obligor (as a guarantor or borrower) (i) between or among the Parent Guarantor and any subsidiary or subsidiaries thereof or (ii) between or among any subsidiaries of the Parent Guarantor.

As of the date of the Indenture, RAI will be the only Subsidiary Guarantor to which the above provision is relevant.

Payment of Additional Amounts

The Issuer or, if applicable, each Guarantor will make payments of, or in respect of, principal, premium (if any) and interest on the Notes, or any payment pursuant to the applicable Guarantee, as the case may be, without withholding or deduction for or on account of any present or future tax, levy, impost or other similar governmental charge whatsoever imposed, assessed, levied or collected ("Taxes") by or for the account of the United States, the United Kingdom (in the case of a payment by the Parent Guarantor or BATIF), The Netherlands (in the case of a payment by a Dutch Guarantor) or any other jurisdiction through which payment is made by or on behalf of the Issuer or, if applicable, such Guarantor (or any political subdivision thereof or any authority thereof having the power to tax) (a "Relevant Taxing Jurisdiction"), unless such withholding or deduction is required by law.

If the Issuer or, if applicable, any Guarantor, is required by a Relevant Taxing Jurisdiction to so withhold or deduct such Taxes, the Issuer or, if applicable, such Guarantor, will pay to the holder of a Note such additional amounts ("Additional Amounts") as may be necessary so that the net amount received by such holder will not be less than the amount such holder would have received if such Taxes had not been withheld or deducted; *provided, however*, that amounts with respect to any United States Tax shall be payable only to holders that are not United States persons (within the meaning of the Code) and *provided further*, that neither the Issuer nor such Guarantor shall be required to pay any Additional Amounts for or on account of:

(i) any Taxes that would not have been so imposed, assessed, levied or collected but for the fact that the holder or beneficial owner of the applicable Note or Guarantee (or a fiduciary, settlor, beneficiary, member or shareholder of, or possessor of a power over, such holder, if such holder is an estate, trust, partnership or corporation) is or has been a domiciliary, national or resident of, or engaging or having been engaged in a trade or business or maintaining or having maintained a permanent establishment or being or having been physically present in, a Relevant Taxing Jurisdiction or otherwise having or having had some connection with a Relevant Taxing Jurisdiction other than the holding or ownership of, or the collection of principal of, and premium (if any) or interest on, a Note or the enforcement of the applicable Guarantee, as the case may be;

(ii) any Taxes that would not have been so imposed, assessed, levied or collected but for the fact that, where presentation is required in order to receive payment, the applicable Note or Guarantee was presented more than 30 days after the date on which such payment became due and payable or was provided for, whichever is later, except to the extent that the holder or beneficial owner thereof would have been entitled to Additional Amounts had the applicable Note or Guarantee been presented for payment on any day during such 30 day period;

(iii) any estate, inheritance, gift, sales, transfer, personal property or similar Taxes;

(iv) any Taxes that are payable otherwise than by withholding or deduction from payments on or in respect of the applicable Note or Guarantee;

(v) any Taxes that would not have been so imposed, assessed, levied or collected but for the failure by the holder or the beneficial owner of the applicable Note or Guarantee to (A) provide any certification, identification, information, documents or other evidence concerning the nationality, residence or identity of the holder or the beneficial owner or its connection with the Relevant Taxing Jurisdiction or (B) make any valid or timely declaration or claim or satisfy any other reporting, information or procedural requirements relating to such matters if, in either case, compliance is required by statute, regulation, relevant income tax treaty or administrative practice of the Relevant Taxing Jurisdiction as a condition to relief or exemption from such Taxes;

(vi) any Taxes imposed by reason of the holder or the beneficial owner of the applicable Note or Guarantee being or having been considered a bank receiving payments on an extension of credit made pursuant to a loan agreement entered into in the ordinary course of its trade or business, as described in Section 881(c)(3)(A) of the Code (or any amended or successor provisions);

(vii) any Taxes imposed on interest received by a 10-percent shareholder of the Issuer within the meaning of Section 871(h)(3)(B) or Section 881(c)(3)(B) of the Code (or any amended or successor provisions);

(viii) any backup withholding imposed pursuant to Section 3406 of the Code (or any amended or successor provisons);

(ix) any Taxes imposed pursuant to Section 871(h)(6) or Section 881(c)(6) of the Code (or any amended or successor provisions);

(x) any Taxes imposed by reason of the holder or the beneficial owner of the applicable Note or Guarantee being or having been a personal holding company, passive foreign investment company or controlled foreign corporation for U.S. federal income tax purposes or a corporation that has accumulated earnings to avoid U.S. federal income tax;

(xi) any Taxes imposed or withheld pursuant to Sections 1471 through 1474 of the Code (or any amended or successor provisions), any Treasury regulations promulgated thereunder, any official interpretations thereof or any agreements entered into in connection with the implementation thereof; or

(xii) any combination of the Taxes described in (i) through (xi) above.

In addition, Additional Amounts will not be paid with respect to any payment of the principal of, or any premium or interest on, any of the applicable Notes or Guarantees to any holder that is a fiduciary, a partnership, a limited liability company or any person other than the sole beneficial owner of such payment to the extent a beneficiary or settlor with respect to such fiduciary, a member of such partnership, an interest holder in such limited liability company or a beneficial owner that would not have been entitled to such amounts had such beneficiary, settlor, member, interest holder or beneficial owner been the holder of the applicable Notes or Guarantees.

Unless otherwise stated, references in any context to the payment of principal of, and any premium or interest on, any Note, or any payment pursuant to the Guarantees, will be deemed to include payment of Additional Amounts to the extent that, in such context, Additional Amounts are, were or would be payable in respect thereof.

Redemption

The Fixed Rate Notes and certain of the Floating Rate Notes will be subject to optional redemption by the Issuer as described below under "— *Optional Redemption*". Series of Floating Rate Notes having a maturity date that is less than five years from the issue date will not be subject to such optional redemption by the Issuer.

Both the Fixed Rate Notes and the Floating Rate Notes will be subject to optional redemption by the Issuer in the event of certain changes in tax laws applicable to payments in respect of the Notes as described below under "— *Redemption for Tax Reasons*".

Optional Redemption

The Issuer may redeem the Fixed Rate Notes, in whole or in part, at the Issuer's option, at any time and from time to time (i) at all times in respect of the 2020 Fixed Rate Notes or (ii) before the applicable Par Call Date, for all other series of Fixed Rate Notes at a redemption price equal to the greater of (x) 100% of the principal amount of the Fixed Rate Notes to be redeemed and (y) as determined by the Independent Investment Banker (as defined below), the sum of the present values of the applicable Remaining Scheduled Payments (as defined below) discounted to the date of redemption (the "Redemption Date") on a semi-annual basis (assuming a 360-day year consisting of twelve 30-day months or, in the case of an incomplete month, the number of days

elapsed) at the Treasury Rate (as defined below) plus, in the case of each respective series of Fixed Rate Notes as follows:

2020 Fixed Rate Notes	15 basis points
2022 Fixed Rate Notes	15 basis points
2024 Fixed Rate Notes	20 basis points
2027 Fixed Rate Notes	20 basis points
2037 Fixed Rate Notes	25 basis points
2047 Fixed Rate Notes	30 basis points

together with, in each case, accrued and unpaid interest on the principal amount of the Fixed Rate Notes to be redeemed to, but excluding, the Redemption Date.

If the Issuer elects to redeem the 2022 Fixed Rate Notes, 2024 Fixed Rate Notes, 2027 Fixed Rate Notes, 2037 Fixed Rate Notes, 2047 Fixed Rate Notes or the 2022 Floating Rate Notes on or after the applicable Par Call Date (as defined below), the Issuer will pay an amount equal to 100% of the principal amount of the Notes redeemed, plus accrued and unpaid interest, if any, to, but excluding, the date of redemption.

In connection with such optional redemption the following defined terms apply:

- *Comparable Treasury Issue* means the United States Treasury security selected by the Independent Investment Banker that would be utilized, at the time of selection and in accordance with customary financial practice, in pricing new issues of corporate debt securities of comparable maturity to, the remaining term of the 2020 Fixed Rate Notes, 2022 Fixed Rate Notes, 2024 Fixed Rate Notes, 2027 Fixed Rate Notes, 2037 Fixed Rate Notes or the 2047 Fixed Rate Notes, as the case may be, to the relevant Par Call Date.

- *Comparable Treasury Price* means, with respect to any Redemption Date, (A) the average of the Reference Treasury Dealer Quotations for that Redemption Date, after excluding the highest and lowest of such Reference Treasury Dealer Quotations or (B) if the Independent Investment Banker for the Fixed Rate Notes obtains fewer than four such Reference Treasury Dealer Quotations, the average of all such Quotations.

- *Independent Investment Banker* means one of the Reference Treasury Dealers (as defined below) appointed by the Issuer to act as the "Independent Investment Banker".

- *Par Call Date* means (i) July 15, 2022 with respect to any 2022 Fixed Rate Notes (one month prior to the maturity date of the 2022 Fixed Rate Notes), (ii) June 15, 2024 with respect to any 2024 Fixed Rate Notes (two months prior to the maturity date of the 2024 Fixed Rate Notes), (iii) May 15, 2027 with respect to any 2027 Fixed Rate Notes (three months prior to the maturity date of the 2027 Fixed Rate Notes), (iv) February 15, 2037 with respect to any 2037 Fixed Rate Notes (six months prior to the maturity date of the 2037 Fixed Rate Notes), (v) February 15, 2047 with respect to any 2047 Fixed Rate Notes (six months prior to the maturity date of the 2047 Fixed Rate Notes) and (vi) July 15, 2022 with respect to any 2022 Floating Rate Notes (one month prior to the maturity date of the 2022 Floating Rate Notes).

- *Reference Treasury Dealer* means each of Merrill Lynch, Pierce, Fenner & Smith Incorporated, Barclays Capital Inc., Citigroup Global Markets Inc., Deutsche Bank Securities Inc. and HSBC Securities (USA) Inc. and their respective successors and two other nationally recognized investment banking firms that are Primary Treasury Dealers specified from time to time by the Issuer; *provided, however,* that if any of the foregoing shall cease to be a primary U.S. Government securities dealer in New York City (a "Primary Treasury Dealer"), the Issuer shall substitute therefor another nationally recognized investment banking firm that is a Primary Treasury Dealer.

- *Reference Treasury Dealer Quotation* means, with respect to each Reference Treasury Dealer and any Redemption Date, the average, as determined by the Independent Investment Banker, of the bid and asked prices for the Comparable Treasury Issue (expressed in each case as a percentage of its principal amount) quoted in writing to the Independent Investment Banker by such Reference Treasury Dealer at 3:30 p.m., New York City time, on the third Business Day immediately preceding that Redemption Date.

- *Remaining Scheduled Payments* means, with respect to each Fixed Rate Note to be redeemed, the remaining scheduled payments of the principal thereof and interest thereon that would be due from and including the related Redemption Date, but for such redemption, to but excluding the relevant Par Call Date; *provided, however,* that if that Redemption Date is not an Interest Payment Date with respect to

such Fixed Rate Notes, the amount of the next succeeding scheduled interest payment thereon will be reduced by the amount of interest accrued thereon to that Redemption Date.

- *Treasury Rate* means, with respect to any Redemption Date, the rate per annum equal to the semi-annual equivalent yield to maturity (computed as of the third Business Day immediately preceding that Redemption Date) of the Comparable Treasury Issue, assuming a price for the Comparable Treasury Issue (expressed as a percentage of its principal amount) equal to the Comparable Treasury Price for that Redemption Date.

Notice of any optional redemption will be given in accordance with "— *Notice*" below at least 10 days but not more than 30 days before the Redemption Date to each holder of the Fixed Rate Notes to be redeemed.

If less than all the Fixed Rate Notes are to be redeemed, in the case of a redemption at the Issuer's option as discussed in this section, the Fixed Rate Notes to be redeemed shall be selected in accordance with applicable procedures of DTC.

Redemption for Tax Reasons

Each series of Notes is also redeemable by the Issuer, in whole but not in part, at 100% of the principal amount of such Notes plus any accrued and unpaid interest to the applicable Redemption Date (including any Additional Amounts) at the Issuer's option at any time prior to their maturity if, due to a Change in Tax Law (as defined below): (i) the Issuer or a Guarantor, in accordance with the terms of the applicable Notes or applicable Guarantee, has, or would, become obligated to pay any Additional Amounts to the holders or beneficial owners of the Notes of that series; (ii) in the case of a Guarantor, (A) the Parent Guarantor would be unable, for reasons outside its control, to procure payment by the Issuer or any other Guarantor or (B) the procuring of such payment by the Issuer and each such other Guarantor would be subject to withholding taxes imposed by a Relevant Taxing Jurisdiction; and (iii) such obligation cannot otherwise be avoided by such Guarantor, the Parent Guarantor or the Issuer, taking reasonable measures available to it. In such case, the Issuer may redeem the applicable Notes upon not less than 30 nor more than 60 days' notice as provided in "— *Notice*" below, at 100% of the principal amount of such Notes plus accrued and unpaid interest to the Redemption Date (including Additional Amounts); *provided,* that, (a) no such notice of redemption shall be given earlier than 90 days prior to the earliest date on which the Issuer or such Guarantor, as the case may be, would be obligated to pay any such Additional Amounts in respect of the applicable Notes or applicable Guarantee, as applicable, then due and (b) at the time such notice is given, such obligation to pay such Additional Amounts remains in effect. The Issuer's right to redeem the applicable Notes shall continue as long as the Issuer or a Guarantor is obligated to pay such Additional Amounts, notwithstanding that the Issuer or such Guarantor, as the case may be, shall have made payments of Additional Amounts. Prior to the giving of any such notice of redemption, the Issuer must deliver to the Trustee: (i) an officer's certificate stating that the Issuer is entitled to effect such redemption and setting forth a statement of facts showing that the conditions precedent to the right of the Issuer so to redeem have occurred; and (ii) an opinion of independent counsel or an independent accountant of recognized standing, selected by the Issuer or any Guarantor, as applicable, with respect to tax matters of the Relevant Taxing Jurisdiction to the effect that the Issuer or such Guarantor has, or would, become obligated to pay such Additional Amounts as a result of such Change in Tax Law.

For the purposes hereof, "Change in Tax Law" shall mean: (i) any changes in, or amendment to, any law of a Relevant Taxing Jurisdiction (including any regulations or rulings promulgated thereunder and including, for this purpose, any treaty entered into by the Relevant Taxing Jurisdiction) or any amendment to or change in the application or official interpretation (including judicial or administrative interpretation) of such law, which change or amendment becomes effective or, in the case of an official interpretation, is announced, on or after August 15, 2017; or (ii) if the Issuer or a Guarantor consolidates, merges, amalgamates or combines with, or transfers or leases its assets substantially as an entirety to, any person that is incorporated or tax resident under the laws of any jurisdiction other than a Relevant Taxing Jurisdiction (a "successor") and as a consequence thereof such person becomes the successor obligor to the Issuer or such Guarantor in respect of Additional Amounts that may become payable (in which case, for purposes of this redemption provision, all references to the Issuer or such Guarantor shall be deemed to be and include references to such person), any change in, or amendment to, any law of the jurisdiction of organization or tax residence of such successor, or the jurisdiction through which payments will be made by the successor, or any political subdivision or taxing authority thereof or thereon for purposes of taxation (including any regulations or rulings promulgated thereunder and including, for this purpose, any treaty entered into by such jurisdiction) or any amendment to or change in the application or official interpretation (including judicial or administrative interpretation) of such law, which change or amendment becomes effective or, in the case of an official interpretation, is announced, on or after the date of such consolidation, merger, amalgamation, combination or other transaction.

General

Upon presentation of any Fixed Rate Note redeemed in part only, the Issuer will execute and the Paying Agent will authenticate and deliver (or cause to be transferred by book-entry) to, or on, the order of the holder thereof, at the expense of the Issuer, a new Fixed Rate Note or Fixed Rate Notes, of authorized denominations, in principal amount equal to the unredeemed portion of the Note so presented.

On or before any Redemption Date (as defined above), the Issuer shall deposit with the Paying Agent money sufficient to pay the redemption price of and accrued and unpaid interest on the Notes to be redeemed on such date. The redemption price shall be calculated by the Independent Investment Banker and the Issuer, and the Trustee and any agent shall be entitled to rely on such calculation.

On and after any Redemption Date, interest will cease to accrue on the Notes or any portion thereof called for redemption.

Maturity

Unless previously purchased or redeemed by the Issuer, and cancelled, the principal amount of each respective series of Notes shall mature on:

Series of Notes	*Maturity date*
2020 Fixed Rate Notes	August 14, 2020
2022 Fixed Rate Notes	August 15, 2022
2024 Fixed Rate Notes	August 15, 2024
2027 Fixed Rate Notes	August 15, 2027
2037 Fixed Rate Notes	August 15, 2037
2047 Fixed Rate Notes	August 15, 2047
2020 Floating Rate Notes	August 14, 2020
2022 Floating Rate Notes	August 15, 2022

in an amount equal, in each case, to their principal amount, with accrued and unpaid interest to such date.

Reacquisition

There is no restriction on the ability of the Issuer to purchase or repurchase Notes, *provided,* that any Notes so repurchased shall be cancelled and not reissued.

Sinking Fund

There is no provision for a sinking fund for any of the Notes.

Certain Definitions

Set forth below is a summary of certain of the defined terms used in the Notes and the Indenture. You should refer to the Notes and the Indenture for the full definition of all defined terms as well as any other terms used herein for which no definition is provided.

"EMTN Programme" means the Euro Medium Term Note Programme to which BATIF, BATCAP, BATHTN and BATNF are parties as the issuers under the programme and notes issued thereunder are guaranteed by the Parent Guarantor, each of the issuers thereunder (except when it is the relevant issuer) and RAI, as amended from time to time.

"Person" means any individual, corporation, partnership, joint venture, association, limited liability company, joint stock company, trust, unincorporated organization or government or any agency or political subdivision thereof.

"Quoted Borrowing" means any indebtedness which: (a) is represented by notes, debentures or other securities issued otherwise than to constitute or represent advances made by banks and/or other lending institutions; (b) is denominated, or confers any right to payment of principal and/or interest, in or by reference to any currency other than the currency of the country in which the issuer of the indebtedness has its principal place of business or is denominated, or confers any right to payment of principal and/or interest, in or by reference to the currency of such country but is placed or offered for subscription or sale by or on behalf of, or by agreement with, the issuer of such indebtedness as to over 20% outside such country; and (c) at its date of issue is, or is intended by the issuer of such indebtedness to become, quoted, listed, traded or dealt in on any stock exchange or other organized and regulated securities market in any part of the world.

Covenants of the Issuer and the Guarantors

Negative Pledge

The Indenture will provide that so long as any of the applicable Notes remains outstanding, neither the Issuer nor any Guarantor will secure or allow to be secured any Quoted Borrowing or any payment under any guarantee by any of them of any Quoted Borrowing by any mortgage, charge, pledge or lien (other than arising by operation of law) upon any of its undertaking or assets, whether present or future, unless at the same time the same mortgage, charge, pledge or lien is extended, or security which is not materially less beneficial to the holders of the applicable Notes than the security given as aforesaid or which shall be approved by consent of the holders of not less than 75% in aggregate principal amount of the applicable Notes at the time outstanding is extended or created (as the case may be), to secure equally and ratably the principal of, and interest on, and all other payments (if any) in respect of the applicable Notes.

Limitation on Mergers, Consolidations, Amalgamations and Combinations

So long as any of the applicable Notes remain outstanding, neither the Issuer nor any Guarantor may consolidate with or merge into any other person or sell, convey, transfer or lease its properties and assets as an entirety or substantially as an entirety to any person (other than any sale or conveyance by way of a lease in the ordinary course of business), unless: (i) in the case of the Issuer, any successor person assumes the Issuer's obligations on the applicable Notes and under the Indenture and, in the case of any Guarantor, any successor person assumes such Guarantor's obligations on the applicable Guarantee and under the Indenture; (ii) immediately after giving effect to such transaction, no Event of Default, and no event which, after notice or lapse of time or both, would become an Event of Default, shall have occurred and be continuing; (iii) such successor person is organized under the laws of the United States, the United Kingdom, The Netherlands or any other country that is a member of the Organization for Economic Cooperation and Development as of the date of such succession; (iv) such successor person agrees to pay any Additional Amounts imposed by the jurisdiction in which such successor person is incorporated or otherwise a resident for tax purposes or through which payments are made and resulting therefrom or otherwise; and (v) if as a result of such consolidation or merger or such sale, conveyance, transfer or lease, properties or assets of the Issuer or any Guarantor would become subject to a mortgage, pledge, security interest, lien or similar encumbrance to secure payment of any indebtedness for borrowed money of the Issuer or a Guarantor which would not be permitted by the applicable Notes or under the Indenture, the Issuer or any Guarantor or such successor person, as the case may be, shall take such steps as shall be necessary to effectively secure the Notes equally and ratably with (or prior to) all indebtedness for borrowed money secured thereby.

The limitation on mergers, consolidations, amalgamations and combinations contained in this section "— *Limitation on Mergers, Consolidations, Amalgamations and Combinations*" shall not apply to any consolidation, merger, amalgamation or combination in which the Issuer or applicable Guarantor is the surviving corporation except that, in such case, the provisions of (ii) and (v) above shall apply such that: (x) immediately after giving effect to such transaction, no Event of Default, and no event which, after notice or lapse of time or both, would become an Event of Default, shall have occurred and be continuing; and (y) if as a result of such consolidation or merger or such sale, conveyance, transfer or lease, properties or assets of the Issuer or any Guarantor would become subject to a mortgage, pledge, security interest, lien or similar encumbrance to secure payment of any indebtedness for borrowed money of the Issuer or a Guarantor which would not be permitted by the applicable Notes or under the Indenture, the Issuer or any Guarantor, as the case may be, shall take such steps as shall be necessary to effectively secure the Notes equally and ratably with (or prior to) all indebtedness for borrowed money secured thereby.

The Indenture will not contain covenants or other provisions to afford protection to holders of the Notes in the event of a highly leveraged transaction or a change in control of the Issuer or any Guarantor except as provided above.

Upon certain mergers or consolidations involving the Issuer or a Guarantor, or upon certain sales or conveyances of the properties of the Issuer or a Guarantor, the obligations of the Issuer or such Guarantor, under the applicable Notes or the applicable Guarantee, shall be assumed by the person formed by such merger or consolidation or which shall have acquired such property and upon such assumptions such person shall succeed to and be substituted for the Issuer or such Guarantor, as the case may be, and then the Issuer or such Guarantor will be relieved from all obligations under the Notes and the applicable Guarantee, as the case may be. The terms "Issuer" and "Guarantor", as used in the Notes and the Indenture, also refer to any such successors or assigns so substituted.

Although there is a limited body of case law interpreting the phrase "entirety or substantially as an entirety," there is no precise established definition of the phrase under applicable law. Accordingly, in certain

circumstances, there may be a degree of uncertainty as to whether a particular transaction would involve a disposition of "entirety or substantially as an entirety" of the Issuer's assets and its subsidiaries taken as a whole.

Events of Default

The following will be Events of Default (each an "Event of Default") with respect to the applicable Notes:

(i) *Non-Payment:* default is made in the payment of: (a) any installment of interest (excluding Additional Amounts) upon any applicable Note as and when the same shall become due and payable, and continuance of such default for a period of 14 days or more; (b) applicable Additional Amounts as and when the same shall become due and payable, and continuance of such default for a period of 14 days; or (c) all or any part of the principal or premium, if any, of any applicable Note as and when the same shall become due and payable either at maturity, upon any redemption, by declaration or otherwise, and continuance of such default for 3 days;

(ii) *Breach of Other Obligations:* the Issuer or any Guarantor does not perform or comply with any one or more of its other obligations under the applicable Notes or the Indenture (other than those described in paragraph (i) above) which is not remedied within 30 days after written notice of such default shall have been given to the Issuer by the Trustee or to the Issuer and the Trustee by the holders of at least 25% of the outstanding principal amount of the Notes;

(iii) *Cross-Default:* (a) any other present or future indebtedness for borrowed money of the Issuer or any Guarantor, other than the Notes issued by the Issuer, becomes due and payable prior to its stated maturity by reason of any default or event of default in respect thereof by the Issuer or any Guarantor and remains unpaid; or (b) any such indebtedness for borrowed money is not paid when due or, as the case may be, within any applicable grace period; or (c) the Issuer or any Guarantor fails to pay when due and called upon (after the expiry of any applicable grace period) any amount payable by it under any present or future guarantee for, or indemnity in respect of, any indebtedness for borrowed money and which remains unpaid; provided that (x) payment of the indebtedness for borrowed money is not being contested in good faith and in accordance with legal advice or (y) the aggregate amount of the indebtedness for borrowed money, guarantees and indemnities in respect of which one or more of the events mentioned above in (a), (b) and (c) has or have occurred and is or are continuing, equals or exceeds £750 million or its equivalent in any other currency of the indebtedness for borrowed money or, if greater, 1.25% of the Total Equity of the Parent Guarantor, as set out in the "Total Equity" line item in the most recent consolidated group balance sheet of the Parent Guarantor and its subsidiaries in the Parent Guarantor's most recent Annual Report;

(iv) *Cessation of Guarantees:* any Guarantee ceases to be in full force and effect (except as contemplated by the terms of the Indenture) or any Guarantor denies or disaffirms in writing its obligations under the Indenture or Guarantee;

(v) *Enforcement Proceedings:* a distress or execution or other legal process is levied or enforced against or an encumbrancer takes possession of or a receiver, administrative receiver or other similar officer is appointed of the whole or a part of the assets of the Issuer or any Guarantor which is substantial in relation to the BAT Group taken as a whole and is not discharged, stayed, removed or paid out within 45 days after such execution or appointment;

(vi) *Security Enforced:* any mortgage, charge, pledge, lien or other encumbrance, present or future, created or assumed by the Issuer or any Guarantor becomes enforceable and any step is taken to enforce it (including the taking of possession or the appointment of a receiver, administrative receiver, manager or other similar person) against all or substantially all of the assets of the Issuer or any Guarantor and is not discharged within 45 days;

(vii) *Insolvency:* the Issuer or any Guarantor is insolvent or bankrupt or unable to pay its debts (in respect of companies incorporated in England and Wales, within the meaning of Sections 123(1)(b) or (e) or Section 123(2) of the UK Insolvency Act 1986), stops, suspends or threatens to stop or suspend payment of all or a material part of its debts, proposes or makes a general assignment or an arrangement or composition (otherwise than for the purposes of reconstruction, amalgamation, reorganization, merger or consolidation or other similar arrangement) with or for the benefit of its creditors in respect of any of such debts or a moratorium is agreed or declared in respect of or affecting all or a material part of the debts of the Issuer;

(viii) *Winding-up:* an order is made or an effective resolution passed for the winding-up or dissolution or administration of the Issuer or any Guarantor, or the Issuer or any Guarantor shall apply or petition for a winding-up or administration order in respect of itself or ceases or threatens to cease to carry on all or

substantially all of its business or operations, in each case except for the purpose of and followed by a reconstruction, amalgamation, reorganization, merger or consolidation or other similar arrangement; or

(ix) *Analogous Events:* any event occurs that under the laws of any relevant jurisdiction has an analogous effect to any of the events referred to in any of the foregoing paragraphs (vii) and (viii).

The Indenture will provide that if an Event of Default occurs and is continuing with respect to the Notes of a series, then and in each and every such case (other than certain Events of Default specified in paragraphs (vii), (viii) and (ix) above with respect to the Issuer or any Guarantor), unless the principal of all the applicable Notes shall have already become due and payable, the holders of not less than 25% in aggregate principal amount of the applicable Notes then outstanding, by notice in writing to the Issuer, each Guarantor and the Trustee, may declare the entire principal amount of all applicable Notes issued pursuant to the Indenture and interest accrued and unpaid thereon, if any, to be due and payable immediately, and upon any such declaration the same shall become immediately due and payable, without any further declaration or other act on the part of any holder. If certain Events of Default described in paragraph (vii), (viii) or (ix) above occur with respect to the Issuer and are continuing, the principal amount of and accrued and unpaid interest on all the applicable Notes issued pursuant to the Indenture shall become immediately due and payable, without any declaration or other act on the part of the Trustee or any holder. Under certain circumstances, the holders of a majority in aggregate principal amount of the applicable Notes then outstanding, by written notice to the Issuer, each Guarantor and the Trustee, may waive defaults and rescind and annul declarations of acceleration and its consequences, but no such waiver or rescission and annulment shall extend to or shall affect any subsequent default or shall impart any right consequent thereon.

The holders of a majority in aggregate principal amount of the applicable Notes then outstanding will have the right to direct the time, method and place of conducting any proceeding for any remedy available to the Trustee, or exercising any trust or power conferred on the Trustee, subject to certain limitations to be specified in the Indenture, including providing to the Trustee indemnity satisfactory to it.

An Event of Default with respect to any series of Notes would not necessarily constitute an event of default with respect to the other series of Notes.

The Indenture will also provide that no holder of any Notes governed by the Indenture may institute any action or proceeding at law or in equity or in bankruptcy or otherwise upon or under or with respect to the Indenture, or for the appointment of a trustee, receiver, liquidator, custodian or other similar official or for any other remedy under the Indenture (except suits for the enforcement of payment of overdue principal or interest) unless (1) the holder of a Note gives to the Trustee written notice of a continuing Event of Default, (2) the holders of at least 25% in principal amount of the then outstanding Notes make a written request to the Trustee to pursue the remedy, (3) the holder or holders of Notes offer, and if requested, provide to the Trustee indemnity reasonably satisfactory to the Trustee against any loss, liability or expense, (4) the Trustee does not comply with the request within 60 days after receipt of the request and the offer and, if requested, the provision of indemnity and (5) during such 60-day period the holders of a majority in principal amount of the then outstanding Notes do not give the Trustee a direction inconsistent with the request. The holder of a Note may not use the Indenture to prejudice the rights of another holder of a Note or to obtain a preference or priority over another holder of a Note (it being understood that the Trustee does not have an affirmative duty to ascertain whether or not such actions or forbearances are unduly prejudicial to such holders).

Satisfaction and Discharge

The Indenture will, subject to satisfying certain conditions, provide that BAT may discharge certain obligations to the holders of Notes of any series of Notes that have not already been delivered to the Trustee for cancellation and that either have become due and payable or will become due and payable within one year (or scheduled for redemption within one year) by depositing with the Trustee or Paying Agent, in trust, funds in an amount sufficient to pay the entire indebtedness on such series of Notes in respect of principal and premium, if any, and interest, if any, to the date of such deposit (if such Notes have become due and payable) or to the maturity thereof or redemption date, as the case may be, along with an officer's certificate and an opinion of counsel stating that all conditions precedent relating to the satisfaction and discharge of the Indenture have been complied with.

Defeasance

The Indenture will provide that the Issuer will have the option either (a) to be deemed (together with each Guarantor) to have paid and discharged the entire indebtedness represented by, and obligations under, a series of Notes and the applicable Guarantees and to have satisfied all the obligations under the Indenture relating to the series of Notes (except for certain obligations, including those relating to the defeasance trust and obligations to

register the transfer or exchange of Notes, to replace mutilated, destroyed, lost or stolen Notes and to maintain paying agencies) on the 91st day after the applicable conditions described below have been satisfied or (b) to cease (together with each Guarantor) to be under any obligation to comply with the covenant described above under "— *Covenants of the Issuer and the Guarantors — Negative Pledge*" and the condition relating to the absence of any events of default under "— *Covenants of the Issuer and the Guarantors — Limitation on Mergers, Consolidations, Amalgamations and Combinations*" under the Indenture, and non-compliance with such covenants and the occurrence of all events described above under "— *Events of Default*" will not give rise to any Event of Default under the Indenture, at any time after the applicable conditions described below have been satisfied.

In order to exercise either defeasance option, the Issuer must (i) deposit with the Trustee or Paying Agent, irrevocably in money or Government Obligations (as defined in the Indenture) funds sufficient in the opinion of a certified public accounting firm of national reputation for the payment of principal of and interest on the applicable outstanding Notes of any series to and including the Redemption Date irrevocably designated by the Issuer on or prior to the date of deposit of such money or Government Obligations, and must (ii) comply with certain other conditions, including delivering to the Trustee an opinion of U.S. counsel to the effect that beneficial owners of the applicable Notes will not recognize income, gain or loss for United States federal income tax purposes as a result of the exercise of such option and will be subject to United States federal income tax on the same amount and in the same manner and at the same time as would have been the case if such option had not been exercised and, in the case of clause (a) in the previous paragraph, which opinion must state that such opinion is based on a ruling received from or published by the United States Internal Revenue Service or on a change of law after August 15, 2017.

Modification and Waiver

Without Consent of Noteholders

The Indenture will contain provisions permitting the Issuer, each Guarantor and the Trustee, without the consent of the holders of any of the applicable Notes at any time outstanding under such Indenture, from time to time and at any time, to enter into a supplemental indenture amending or supplementing such Indenture, the Notes or the Guarantees in order to:

- convey, transfer, assign, mortgage or pledge to the holders of the applicable Notes or any person acting on their behalf as security for the applicable Notes any property or assets;
- evidence the succession of another person to the Issuer or any Guarantor, as the case may be, or successive successions, and the assumption by the successor person(s) of the covenants, agreements and obligations of the Issuer or any Guarantor, as the case may be, pursuant to the Indenture;
- evidence and provide for the acceptance of appointment of a successor or successors to the Trustee and/or the Paying Agent, Transfer Agent, Calculation Agent and Registrar, as applicable;
- add to the covenants of, or the restrictions, conditions or provisions applicable to, the Issuer and any Guarantor, as the case may be, such further covenants, restrictions, conditions or provisions as the Issuer and any Guarantor, as the case may be, shall consider to be for the protection of the holders of the applicable Notes issued pursuant to the Indenture, including to eliminate one or both prongs of the release provision under "— *Release*", and to make the occurrence, or the occurrence and continuance, of a default in any such additional covenants, restrictions, conditions or provisions an Event of Default under the Indenture permitting the enforcement of all or any of the several remedies provided in the Indenture; *provided* that, in respect of any such additional covenant, restriction, condition or provision, such supplemental indenture may provide for a particular period of grace after default (which may be shorter or longer than that allowed in the case of other defaults) or may limit the remedies available to the Trustee upon such an Event of Default;
- if required by the requirements of the SEC, comply with any requirements of the SEC in connection with the qualification of the Indenture under the TIA;
- modify the restrictions on, and procedures for, resale and other transfers of the applicable Notes pursuant to law, regulation or practice relating to the resale or transfer of restricted securities generally;
- cure any ambiguity or to correct or supplement any provision contained in the Indenture, the Notes, or the Guarantees which may be defective or inconsistent with any other provision contained therein or to make such other provision in regard to matters or questions arising under the Indenture, the Notes or the Guarantees as the Issuer, any Guarantor or the Trustee may deem necessary or desirable and which will not, in the opinion of the Issuer or any Guarantor, adversely affect the interests of the holders of the applicable Notes in any material respect;

- issue an unlimited aggregate principal amount of Notes under the Indenture or to "reopen" the applicable series of Notes and create and issue additional notes having identical terms and conditions as the applicable Notes (or in all respects except for the issue date, issue price, payment of interest accruing prior to the issue date of such additional notes and/or the first payment of interest following the issue date of such additional notes) so that the additional notes are consolidated and form a single series with the outstanding applicable Notes; and
- evidence the addition of any new Guarantor of the Notes and the Indenture, or the release of any Guarantor from its obligations with respect to the Notes and the Indenture, in either case pursuant to the terms of the Indenture.

With Consent of Noteholders

The Indenture will contain provisions permitting the Issuer, each Guarantor and the Trustee, with the consent of the holders of not less than a majority in aggregate principal amount of all series of the Notes affected by such supplemental indenture (voting as one class) at the time outstanding under the Indenture (including consents obtained in connection with a tender offer or exchange offer for the applicable Notes), from time to time and at any time, to enter into a supplemental indenture for the purpose of amending, waiving or otherwise modifying the provisions of the Indenture, the Notes and the Guarantees, or adding any provisions to or changing in any manner or eliminating any of the provisions of the applicable Notes or of modifying in any manner the rights of the holders of the applicable Notes; *provided,* that no such supplemental indenture may, without the consent of the holder of each of the Notes so affected:

- change the stated maturity of the applicable Note of, or the date for payment of any principal of, or installment of interest on, any applicable Note; or
- reduce the principal amount of or the rate or amount of interest on any applicable Note or Additional Amounts payable with respect thereto or reduce the amount payable thereon in the event of redemption or default or change the method for determining the interest rate thereon; or
- change the currency of payment of principal of or interest on any applicable Note or Additional Amounts payable with respect thereto; or change the obligation of the Issuer or any Guarantor, as the case may be, to pay Additional Amounts (except as otherwise permitted by such applicable Note); or
- impair the right to institute suit for the enforcement of any such payment on or with respect to any applicable Note; or
- reduce the percentage of the aggregate principal amount of the applicable Notes outstanding the consent of whose holders is required for any such supplemental indenture; or
- reduce the aggregate principal amount of any applicable Note outstanding necessary to modify or amend the Indenture or any such Note or to waive any future compliance or past default or reduce the quorum requirements or the percentage of aggregate principal amount of any applicable Notes outstanding required for the adoption of any action at any meeting of holders of such Notes or to reduce the percentage of the aggregate principal amount of such Notes outstanding necessary to rescind or annul any declaration of the principal of all accrued and unpaid interest on any Note to be due and payable,

provided, that no consent of any holder of any applicable Note shall be necessary to permit the Trustee, the Issuer and each of the Guarantors to execute supplemental indenture as described under "— *Without Consent of Noteholders*" above.

Any modifications, amendments or waivers to the Indenture or to the conditions of the applicable Notes will be conclusive and binding on all holders of the applicable Notes, whether or not they have consented to such action or were present at the meeting at which such action was taken, and on all future holders of the applicable Notes, whether or not notation of such modifications, amendments or waivers is made upon such Notes. Any instrument given by or on behalf of any holder of such a Note in connection with any consent to any such modification, amendment or waiver will be irrevocable once given and will be conclusive and binding on all subsequent registered holders of such Note.

Restrictions on Transfer

The Initial Purchasers propose to resell the Rule 144A Notes (as defined below) to certain institutions in the United States in reliance upon Rule 144A under the Securities Act. Notes that are initially offered and sold in the United States to "qualified institutional buyers", or "QIBs" (the "Rule 144A Notes") may not be sold or

otherwise transferred except, in the United States, pursuant to registration under the Securities Act or in accordance with Rule 144A or, outside the United States to persons who are not U.S. persons, pursuant to Rule 904 of Regulation S thereunder (the "Regulation S Notes") or, in either case, in a resale transaction that is otherwise exempt from such registration requirements, and each of the Global Notes will bear a legend to this effect. In light of current U.S. securities laws, subject to certain exceptions, an exemption should be available for a sale or transfer of a Rule 144A Note after its Specified Date. The "Specified Date" means, (A) with respect to any Rule 144A Note, the date following the expiration of the applicable required holding period determined pursuant to Rule 144 of the Securities Act (such period, the "applicable holding period") after the later of (i) the date of acquisition of such Rule 144A Note from the Issuer or an affiliate of the Issuer, or (ii) any resale of such Rule 144A Note in reliance on Rule 144 under the Securities Act for the account of either the acquirer or any subsequent holder of such Rule 144A Note, in each case demonstrated to the reasonable satisfaction of the Issuer or applicable Guarantor (which may require delivery of legal opinions); or (B) with respect to any Regulation S Note, the date which is 40 days after the later of the commencement of the offering or the closing date (such period, the "distribution compliance period").

Unless a holder of a Rule 144A Note holds such Rule 144A Note for the entire applicable holding period, such holder may not be able to determine the Specified Date because such holder may not be able to determine the last date on which the Issuer, any Guarantor, or any affiliate thereof, was the beneficial holder of such holder's Rule 144A Note. The Registrar will not be required to accept for registration or transfer any Rule 144A Notes, except upon presentation of satisfactory evidence (which may include legal opinions) that the restrictions on transfer have been complied with, all in accordance with such reasonable regulations as the Issuer and all Guarantors may from time to time agree with such Registrar.

Prescription

Under New York's statute of limitations, any legal action upon the Notes in respect of interest or principal must be commenced within six years after the payment thereof is due.

Notice

So long as the Notes are listed on the Official List of the UK Listing Authority and admitted to trading on the Professional Securities Market of the London Stock Exchange and the rules of the London Stock Exchange so require, notices to holders of Notes will be given by the Issuer by publication in a leading newspaper having general circulation in London, England (which is expected initially to be the *Financial Times*). Notices to holders of Notes will also be given by first-class mail postage prepaid to the last addresses of such holders as they appear in the Notes register; provided, no such mailing shall be required if Notes are held through DTC, as such notice shall be given in accordance with applicable procedures of DTC. Such notices will be deemed to have been given on the date of such publication or mailing.

So long as any Global Notes representing the Notes are held in their entirety on behalf of a clearing system, or any of its participants, there may be substituted for the publication and mailing of notice to holders of Notes described above the delivery of the relevant notices to the clearing system, and its participants, for communication by them to the entitled accountholders. Any such notice shall be deemed to have been given on the day on which the said notice was given to the clearing system, and its participants.

Listing

Although we expect to obtain and maintain a listing for the Notes on the Official List of the UK Listing Authority and to admit the Notes for trading on the PSM, we cannot assure you that our application will be approved or that any series of Notes will be listed and, if listed, that such Notes will remain listed for the entire term of such Notes. If we are unable to obtain or maintain such a listing, we may obtain and maintain listing for the Notes on another exchange in our sole discretion.

Consent to Service

Each of the non-U.S. Guarantors will initially designate BATCAP as their authorized agent for service of process in any legal suit, action or proceeding arising out of or relating to the performance of its obligations under the Indenture and the Notes brought in any state or federal court in the Borough of Manhattan, the City of New York, and will irrevocably submit (but for those purposes only) to the non-exclusive jurisdiction of any such court in any such suit, action or proceeding.

Governing Law

The Indenture, Note and Guarantee shall be governed by and construed in accordance with the laws of the State of New York, without regard to principles of conflicts of laws thereof.

Regarding the Trustee

Wilmington Trust, National Association is the trustee under the Indenture. Citibank, N.A., London Branch has been appointed by the Issuer to act as registrar, transfer agent, calculation agent and paying agent for the Notes. From time to time, Citibank, N.A., London Branch and its affiliates perform various other services for the BAT and its affiliates. Citibank, N.A., London Branch is also the fiscal and paying agent under the fiscal and paying agency agreements for BAT's outstanding 144A notes and the issuing and principal paying agent under BAT's euro medium term note programme.

The Indenture contains limitations on the rights of the trustee, if it becomes a creditor of either Issuer or any Guarantor, to obtain payment of claims in some cases, or to realize on property received in respect of any of these claims as security or otherwise. The Trustee is permitted to engage in other transactions. However, if the Trustee acquires any conflicting interest (as defined in the TIA), it must either eliminate its conflict within 90 days, apply to the SEC for permission to continue or resign.

The Indenture will provide that except during the continuance of an Event of Default, the Trustee will perform only such duties as are specifically set forth in such Indenture. During the continuance of an Event of Default of which the Trustee has received written notice, the Trustee will exercise such of the rights and powers vested in it under the Indenture, and use the same degree of care and skill in their exercise, as a prudent person would exercise or use under the circumstances in the conduct of such person's own affairs.

BOOK ENTRY, DELIVERY AND FORM

The Rule 144A Notes will be represented by beneficial interests in two or more Rule 144A Global Notes in registered form without interest coupons, which will be deposited on or about the closing date of the offering of the Notes with Citibank, N.A., London Branch as custodian (the "Custodian") for DTC and registered in the name of Cede & Co. as nominee of DTC.

The Regulation S Notes will be represented by beneficial interests in two or more Regulation S Global Notes in registered form without interest coupons, which will be deposited on or about the closing date of the offering of the Notes with the Custodian and registered in the name of Cede & Co. as nominee of DTC. Investors may hold their interests in the Regulation S Global Notes directly through DTC if they are participants in, or indirectly through organizations that are participants in, DTC. Euroclear and Clearstream, Luxembourg will hold interests in the Regulation S Global Notes on behalf of their participants through customers' securities accounts in their respective names on the books of their respective depositaries, which are participants in DTC.

So long as DTC or its nominee is the registered holder of a Global Note, DTC or such nominee, as the case may be, will be considered the sole owner or holder of the applicable Notes represented by the applicable Global Note for all purposes under the Indenture and the applicable Notes (except as the context otherwise requires in respect of Additional Amounts). The Notes (including beneficial interests in the Global Notes) will be subject to certain restrictions on transfer set forth therein and in the Indenture and will bear a legend regarding such restrictions as set forth under "— *Restrictions on Transfer*", unless DTC or its nominee determines otherwise in accordance with applicable law. Under certain circumstances, transfers may be made only upon receipt by the Transfer Agent of a written certification (in the form set out in the Indenture).

Transfers within Global Notes

Subject to the procedures and limitations described herein, transfers of beneficial interests within a Global Note may be made without delivery to the Issuer, each of the Guarantors or the Transfer Agent of any written certifications or other documentation by the transferor or transferee.

Transfers between the Global Notes

A beneficial interest in a Rule 144A Global Note may be transferred to a person who wishes to take delivery of such beneficial interest through the applicable Regulation S Global Note only upon receipt by the Transfer Agent of a written certification (in the form set out in the Indenture) from the transferor to the effect that such transfer is being made in accordance with Rule 903 or 904 of Regulation S or, in the case of an exchange occurring following the expiration of the distribution compliance period, Rule 144. Prior to the expiration of the distribution compliance period, a beneficial interest in a Regulation S Global Note may be transferred to a person who wishes to take delivery of such beneficial interest through the applicable Rule 144A Global Note only upon receipt by the Transfer Agent of a written certification (in the form set out in the Indenture) from the transferor to the effect that such transfer is being made to a person whom the transferor reasonably believes is a QIB within the meaning of Rule 144A, in a transaction meeting the requirements of Rule 144A and in accordance with any applicable securities laws of any state of the United States and any other jurisdiction. After the expiration of the distribution compliance period, such certification requirements will no longer apply to such transfers, but such transfers will continue to be subject to applicable transfer restrictions under the Securities Act and the laws of any state of the United States and other jurisdictions. Any beneficial interest in a Rule 144A Global Note or a Regulation S Global Note that is transferred to a person who takes delivery in the form of a beneficial interest in the other Global Note will, upon transfer, cease to be a beneficial interest in such Global Note and become a beneficial interest in the other Global Note and, accordingly, will thereafter be subject to all transfer restrictions and other procedures applicable to a beneficial interest in such other Global Note for so long as such person retains such an interest.

Transfers or Exchanges from a Global Note to Definitive Notes

No Global Note may be exchanged in whole or in part for Notes in definitive registered form ("Definitive Notes") unless:

- DTC notifies the Issuer that it is unwilling or unable to hold the applicable Global Note or DTC ceases to be a clearing agency registered under the Exchange Act, and in each case such Issuer does not appoint a successor depositary that is registered under the Exchange Act within 90 days after receipt of such notice or becoming aware that DTC is no longer so registered;
- a payment default has occurred and is continuing;

- in the event of a bankruptcy default, the Issuer fails to make payment on the applicable Notes when due; or
- the Issuer shall have determined in its sole discretion that the applicable Notes shall no longer be represented by the applicable Global Notes.

The holder of a Definitive Note may transfer such Note by surrendering it at the specified office of the Registrar or the Paying Agent. Upon the transfer, exchange or replacement of Definitive Notes bearing the applicable legend set forth under "*Notice to Investors*" herein, or upon specific request for removal of such legend on a Definitive Note, the Issuer will deliver only Definitive Notes that bear such legend, or will refuse to remove such legend, as the case may be, unless there is delivered to the Issuer and the Registrar such satisfactory evidence, which may include an opinion of counsel, as may reasonably be required by the Issuer, that neither the legend nor the restrictions on transfer set forth therein are required to ensure compliance with the provisions of the Securities Act.

Each such Definitive Note will be endorsed with the applicable Guarantees from each of the Guarantors in the form set out in the Indenture and will include terms substantially in the form of those set forth in the Indenture. Except as set forth in this paragraph, no Global Note may be exchanged in whole or in part for Definitive Notes.

Clearing and Settlement

The information set out below in connection with DTC is subject to any change in or reinterpretation of the rules, regulations and procedures of DTC currently in effect. The information about DTC set forth below has been obtained from sources that the Issuer and each of the Guarantors believe to be reliable, but none of the Issuer, the Guarantors or any of the Initial Purchasers takes any responsibility for or makes any representation or warranty with respect to the accuracy of the information. None of the Issuer, the Guarantors or any of the Initial Purchasers will have any responsibility or liability for any aspect of the records relating to, or payments made on account of interests in Notes held through, the facilities of any clearing system, or for maintaining, supervising or reviewing any records relating to such beneficial ownership interests.

DTC has advised the Issuer and each of the Guarantors as follows: DTC is a limited purpose trust company organized under the laws of the State of New York, a member of the Federal Reserve System, a "clearing corporation" within the meaning of the New York Uniform Commercial Code and a "clearing agency" registered pursuant to the provisions of Section 17A of the Exchange Act. DTC was created to hold securities for DTC participants and to facilitate the clearance and settlement of transactions between DTC participants through electronic book entry changes in accounts of DTC participants, thereby eliminating the need for physical movement of certificates. DTC participants include certain of the Initial Purchasers, securities brokers and dealers, banks, trust companies, and clearing corporations, and may in the future include certain other organizations ("DTC participants"). Indirect access to the DTC system is also available to others such as banks, brokers, dealers and trust companies that clear through or maintain a custodial relationship with a DTC participant, either directly or indirectly ("indirect DTC participants").

Under the rules, regulations, and procedures creating and affecting DTC and its operations (the "Rules"), DTC is required to make book-entry transfers of Notes among DTC participants on whose behalf it acts with respect to Notes accepted into DTC's book-entry settlement system as described below (the "DTC Notes") and to receive and transmit distributions of the nominal amount and interest on the DTC Notes. DTC participants and indirect DTC participants with which beneficial owners of DTC Notes ("Owners") have accounts with respect to the DTC Notes similarly are required to make book-entry transfers and receive and transmit such payments on behalf of their respective Owners. Accordingly, although Owners who hold DTC Notes through DTC participants or indirect DTC participants will not possess Notes, the Rules, by virtue of the requirements described above, provide a mechanism by which such Owners will receive payments and will be able to transfer their interests with respect to the Notes.

Transfers of ownership or other interests in the Notes in DTC may be made only through DTC participants. Indirect DTC participants are required to effect transfers through a DTC participant. DTC has no knowledge of the actual beneficial owners of the Notes. DTC's records reflect only the identity of the DTC participants to whose accounts the Notes are credited, which may not be the beneficial owners. DTC participants will remain responsible for keeping account of their holdings on behalf of their customers and for forwarding all notices concerning the Notes to their customers. So long as DTC, or its nominee, is the registered holder of a Global Note, payments on the applicable Notes will be made in immediately available funds to DTC. DTC's practice is to credit DTC participants' accounts on the applicable payment date in accordance with their respective holdings shown on its records, unless DTC has reason to believe that it will not receive payment on that date. Payments by

DTC participants to beneficial owners will be governed by standing instructions and customary practices, and will be the responsibility of the DTC participants and not of DTC, or any other party, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment to DTC is the responsibility of the Paying Agent. Disbursement of payments for DTC participants will be DTC's responsibility, and disbursement of payments to the beneficial owners will be the responsibility of DTC participants and indirect DTC participants.

Because DTC can only act on behalf of DTC participants, who in turn act on behalf of indirect DTC participants, and because owners of beneficial interests in the Notes holding through DTC will hold interests in the Notes through DTC participants or indirect DTC participants, the ability of the owners of the beneficial interests to pledge Notes to persons or entities that do not participate in DTC, or otherwise take actions with respect to the Notes, may be limited. DTC will take any action permitted to be taken by an Owner only at the direction of one or more DTC participants to whose account with DTC such Owner's DTC Notes are credited. Additionally, DTC has advised the Issuer that it will take such actions with respect to any percentage of the beneficial interest of Owners who hold Notes through DTC participants or indirect participants only at the direction of and on behalf of DTC participants whose account holders include undivided interests that satisfy any such percentage.

To the extent permitted under applicable law and regulations, DTC may take conflicting actions with respect to other undivided interests to the extent that such actions are taken on behalf of DTC participants whose account holders include such undivided interests.

Ownership of interests in the Rule 144A Global Notes and the Regulation S Global Notes will be shown on, and the transfer of that ownership will be effected only through records maintained by, DTC, the DTC participants and the indirect DTC participants, including Euroclear and Clearstream, Luxembourg. Transfers between participants in DTC, as well as transfers between participants in Euroclear and Clearstream, Luxembourg will be effected in the ordinary way in accordance with DTC rules.

Subject to compliance with the transfer restrictions applicable to the Notes, cross-market transfers between DTC, on the one hand, and participants in Euroclear or Clearstream, Luxembourg on the other hand, will be effected in DTC in accordance with DTC rules on behalf of Euroclear or Clearstream, Luxembourg as the case may be. Such cross-market transactions, however, will require delivery of instructions to Euroclear or Clearstream, Luxembourg, as the case may be, by the counterparty in such system in accordance with its rules and procedures and within its established deadlines. Euroclear or Clearstream, Luxembourg, as the case may be, will, if the transaction meets its settlement requirements, deliver instructions to DTC to take action to effect final settlement on its behalf by delivering or receiving payment in accordance with DTC's Same-Day Funds Settlement System.

According to DTC, the foregoing information with respect to DTC has been provided to the industry for informational purposes only and is not intended to serve as a representation, warranty or contract modification of any kind. Although DTC, Euroclear and Clearstream, Luxembourg have agreed to the foregoing procedures in order to facilitate transfers of interests in the Global Notes among participants of DTC, Euroclear and Clearstream, Luxembourg, they are under no obligation to perform or continue to perform such procedures, and such procedures may be discontinued at any time. None of the Issuer, the Guarantors or the Trustee will have any responsibility for the performance by DTC, Euroclear or Clearstream, Luxembourg or their respective participants or indirect participants, of their respective obligations under the rules and procedures governing their operations.

Initial Settlement in Relation to DTC Notes

Upon the issuance of a DTC Note deposited with DTC or a custodian therefor, DTC or its custodian, as the case may be, will credit, on its internal system, the respective nominal amount of the individual beneficial interest represented by such relevant DTC Note or Notes to the accounts of persons who have accounts with DTC. Such accounts initially will be designated by or on behalf of the relevant Initial Purchasers. Ownership of beneficial interest in a DTC Note will be limited to DTC participants, including Euroclear and Clearstream, Luxembourg or indirect DTC participants. Ownership of beneficial interests in DTC Notes will be shown on, and the transfer of that ownership will be effected only through, records maintained by DTC or its nominee (with respect to interests of DTC participants) and the records of DTC participants (with respect to interests of indirect DTC participants). Investors that hold their interests in a DTC Note will follow the settlement procedures applicable to global bond issues. Investors' securities custody accounts will be credited with their holdings against payment in same-day funds on the settlement date.

Secondary Market Trading in Relation to DTC Notes

Since the purchaser determines the place of delivery, it is important to establish at the time of the trade where both the purchaser's and seller's accounts are located to ensure that settlement can be made on the desired value date. Although DTC has agreed to the following procedures in order to facilitate transfers of interests in Global Notes deposited with DTC or a custodian therefor among participants of DTC, DTC is under no obligation to perform or continue to perform such procedures, and such procedures may be discontinued at any time. Neither the Issuer nor any agent of the Issuer will have any responsibility for the performance by DTC or its participants or indirect participants of their respective obligations under the rules and procedures governing their operations.

Secondary market trading between DTC participants will be settled using the procedures applicable to global bond issues in same-day funds.

Payments

So long as any of the Notes remains outstanding, the Issuer will maintain in London, England, so long as the Notes are admitted to listing on the Official List of the UK Listing Authority and to trading on the Professional Securities Market of the London Stock Exchange, an office or agency (a) where the applicable Notes may be presented for payment, (b) in the case of the Issuer, where the applicable Notes may be presented for registration of transfer and for exchange and (c) where notices and demands to or upon the Issuer in respect of the applicable Notes or the Indenture may be served. Each of the Issuer will give the Trustee written notice of the location of any such office or agency and of any change of location thereof. The Issuer will initially designate the Paying Agent for such purposes. The Issuer may also from time to time designate one or more other offices or agencies where the Notes may be presented or surrendered for any or all such purposes or where such notices or demands may be served and may from time to time rescind such designations; *provided, however,* that no such designation or rescission shall in any manner relieve the Issuer of any obligation to maintain an office or agency in London, England for such purposes. The Issuer shall give written notice to the Trustee of any such designation or rescission and of any such change in the location of any other office or agency.

A holder of Notes may transfer or exchange Notes in accordance with their terms. The Registrar for the Notes will not be required to accept for registration or transfer any Notes, except upon presentation of satisfactory evidence (which may include legal opinions) that the restrictions on transfer have been complied with, all in accordance with such reasonable regulations as the Issuer may from time to time agree with such Registrar.

Notwithstanding any statement herein, the Issuer reserves the right to impose or remove such transfer, certification, substitution or other requirements, and to require such restrictive legends on the Notes, as they may determine are necessary to ensure compliance with the securities laws of the United States and the states therein and any other applicable laws or as may be required by any stock exchange on which the Notes are listed. The Issuer may require payment of a sum sufficient to cover any tax or other governmental charge that may be imposed in connection with any exchange or registration of transfer of Notes and any other expenses (including the fees and expenses of the Trustee or Registrar). No service charge will be made for any such transaction.

The Registrar will not be required to exchange or register a transfer of (i) any Notes for a period of 15 days ending the due date for any payment of principal in respect of the Notes or (ii) any Notes selected, called or being called for redemption.

The Notes will be issued in registered form without coupons and transferable in denominations of $2,000 and integral multiples of $1,000 in excess thereof.

The laws of some jurisdictions require that certain persons take physical delivery in definitive form of securities which they own. Consequently, the ability to transfer beneficial interests in the Global Notes is limited to such extent.

REGISTRATION RIGHTS AGREEMENT

This summary of the provisions of the Registration Rights Agreement does not purport to be complete and is subject to, and is qualified in its entirety by reference to, all the provisions of the Registration Rights Agreement, copies of which are available from us upon request.

BATCAP, the Guarantors and the Initial Purchasers will enter into the Registration Rights Agreement on the closing date for the benefit of the holders of the Notes.

Pursuant to the Registration Rights Agreement, the Issuer and the Guarantors will agree, at our own cost, for the benefit of the holders of the applicable series of Notes, to use commercially reasonable efforts to file a registration statement (the "Exchange Offer Registration Statement") with respect to an offer to exchange each series of Notes (each, an "Exchange Offer") for new Notes with the same aggregate principal amount and terms substantially identical in all material respects to the applicable series of Notes offered hereby (except that such new Notes will not contain terms with respect to transfer restrictions or the payment of additional interest); to cause the Exchange Offer Registration Statement to be declared effective by the SEC under the Securities Act; and to consummate the Exchange Offer not later than March 31, 2019 (the "Target Registration Date"). Such Exchange Offer Registration Statement may also pertain to one or more other exchange offers unrelated to this Notes offering.

The Issuer and the Guarantors intend to conduct each Exchange Offer in accordance with the provisions of the Registration Rights Agreement for the applicable series of Notes and the applicable requirements of the Securities Act and the related rules and regulations of the SEC. Notes offered by this Offering Memorandum not tendered in the Exchange Offer will bear interest at the rate set forth on the cover page of this Offering Memorandum and will be subject to all of the terms and conditions specified in the applicable indenture and to the transfer restrictions described in "Notice to Investors."

In the event that (i) the Issuer determines, after consultation with its outside counsel, that the Exchange Offer is not permitted by applicable law or SEC policy and (ii) the Issuer receives a written request (a "Shelf Request") from a holder of the Notes stating that (A) such holder (other than a broker-dealer) is prohibited by applicable law or SEC policy from participating in the Exchange Offer, (B) such holder (other than a broker-dealer) does not receive freely tradable exchange securities on the date of the exchange or (C) such holder is an Initial Purchaser and holds Notes acquired directly from the Issuer or one of its affiliates that are not eligible to be exchanged for exchange securities in the Exchange Offer following consummation of the Exchange Offer, we will, subject to certain conditions, at the cost of the Issuer and the Guarantors, use commercially reasonable efforts to:

(1) file a shelf registration statement covering resales of the Notes, which may be an amendment to the Exchange Offer Registration Statement (the "Shelf Registration Statement");

(2) cause such Shelf Registration Statement to be declared effective under the Securities Act; and

(3) keep the Shelf Registration Statement continuously effective until the earlier of (x) one year from effective date of such Shelf Registration Statement and (y) when all the initial securities covered by such Shelf Registration Statement have been sold pursuant to such Shelf Registration Statement (the "Shelf Effectiveness Period").

Holders will be required to make certain representations to us (as described in the Registration Rights Agreement) in order to participate in the Exchange Offer. A holder that sells its Notes pursuant to the Shelf Registration Statement generally will be required to be named as a selling security holder in the related prospectus and to deliver a prospectus to purchasers, will be subject to certain of the civil liability provisions under the Securities Act in connection with those sales and will be bound by those provisions of the Registration Rights Agreement that are applicable to that holder, including certain indemnification obligations. In order to be named as a selling security holder in the prospectus, the holder must satisfy certain conditions and provide certain representations and information in connection with the Shelf Registration Statement within the time periods set forth in the Registration Rights Agreement.

If:

(1) the Exchange Offer has not been consummated on or prior to the Target Registration Date;

(2) the Shelf Registration Statement, if required because the Issuer has determined, after consultation with its outside counsel, that the Exchange Offer is not permitted by applicable law or SEC policy, has not become effective on or prior to the Target Registration Date;

(3) if the Issuer receives a Shelf Request, the Shelf Registration Statement required to be filed thereby has not become effective by the later of (a) the Target Registration Date and (b) 90 days after delivery of such Shelf Request; or

(4) the Shelf Registration Statement, if required by the Registration Rights Agreement, is filed and declared effective but shall thereafter (during the Shelf Effectiveness Period) cease to be effective or fail to be usable for its intended purpose and such failure to remain effective or usable exists for more than 120 days (whether or not consecutive) in any 12-month period,

(each such event referred to in clauses (1) through (4), a "Registration Default"), the Issuer will agree that the interest rate borne by the relevant Notes shall be increased by 0.25% per annum during the 90-day period immediately following the occurrence of any Registration Default and shall increase by 0.25% per annum at the end of each subsequent 90-day period, but in no event shall such increase exceed 0.50% per annum (any such additional interest payable, the "Additional Interest"). If at any time more than one Registration Default has occurred and is continuing, then, until the next date that there is no Registration Default, the increase in interest rate provided for shall apply as if there occurred a single Registration Default that begins on the date that the earliest Registration Default occurred and ends on such next date that there is no Registration Default. In no event shall Additional Interest accrue after the Shelf Effectiveness Period. Additional Interest shall be the sole remedy available to holders in connection with a Registration Default.

CERTAIN TAXATION CONSIDERATIONS

Prospective investors should consult their professional advisers on the possible tax consequences of buying, holding or selling any Notes in light of their own particular circumstances including the effect of the laws of their country of citizenship, residence or domicile. The discussions that follow for each jurisdiction are based upon the applicable laws and interpretations thereof as in effect as of the date hereof, all of which laws and interpretations are subject to change or differing interpretations, which changes or differing interpretations could apply retroactively.

Material United Kingdom Income Tax Considerations

The comments below are of a general nature and are based on the Issuer's understanding of current United Kingdom tax law as applied in England and Wales and H.M. Revenue & Customs ("HMRC") generally published practice (which may not be binding on HMRC) as of the date of this Offering Memorandum. Any Noteholders who are in doubt as to their personal tax position should consult their professional advisers.

Interest on the Notes

Payments of interest on the Notes by the Issuer may be made without withholding or deduction for or on account of United Kingdom income tax provided such interest is not treated as arising in the United Kingdom for the purposes of Section 874 of the Income Tax Act 2007 ("ITA").

The Notes issued will constitute "quoted Eurobonds" within the meaning of Section 987 of the ITA, provided they are and continue to be listed on a "recognised stock exchange" within the meaning of Section 1005 ITA, and they continue to carry a right to interest. The London Stock Exchange is a recognised stock exchange for these purposes. Securities will be treated as listed on the London Stock Exchange if they are included in the Official List by the UK Listing Authority and are admitted to trading on the Professional Securities Market of the London Stock Exchange, as the Notes are expected to be.

While the Notes are and continue to be quoted Eurobonds, payments of interest on the Notes may be made without withholding or deduction for or on account of United Kingdom tax even if such interest is treated as arising in the United Kingdom for the purposes of Section 874 of the ITA.

Payments in respect of the Guarantee

If the Guarantors are required to make payments under the guarantees and any such payment can be characterized as interest or an annual payment, in either case, with a United Kingdom source, it may have to be paid under deduction of United Kingdom income tax (currently at the rate of 20%), subject to the availability of exemptions including a direction to the Issuer by HMRC pursuant to the provisions of an applicable double tax treaty. Such payments by the Guarantors may not be eligible for the exemption in respect of securities listed on a recognised stock exchange described above in relation to payments of interest by the Issuer.

Material U.S. Federal Income Tax Considerations

The following is a summary of material U.S. federal income tax consequences of the acquisition, ownership and disposition of Notes. This summary deals only with initial purchasers of Notes who purchase the Notes at their "issue price" and that will hold the Notes as capital assets. Generally, the issue price of a Note will be the first price at which a substantial amount of Notes included in the issue of which the Note is a part is sold to persons other than bond houses, brokers or similar persons or organizations acting in the capacity of underwriters, placement agents or wholesalers. The discussion does not cover all aspects of U.S. federal income taxation that may be relevant to, or the actual tax effect that any of the matters described herein will have on, the acquisition, ownership or disposition of Notes by particular investors (including consequences under the alternative minimum tax or net investment income tax), and does not address state, local, non-U.S. or other tax laws. This summary also does not discuss all of the tax considerations that may be relevant to certain types of investors subject to special treatment under the U.S. federal income tax laws (such as certain financial institutions, insurance companies, individual retirement accounts and other tax-deferred accounts, tax-exempt organizations, dealers in securities or currencies, investors that will hold the Notes as part of straddles, hedging transactions or conversion transactions for U.S. federal income tax purposes, certain persons that have ceased to be U.S. citizens or lawful permanent residents of the United States, U.S. citizens or lawful permanent residents living abroad, persons holding the Notes in connection with a trade or business conducted outside of the United States, investors whose functional currency is not the U.S. dollar, or affiliates of the Issuer).

The U.S. federal income tax treatment of a partner in an entity or arrangement treated as a partnership for U.S. federal income tax purposes that holds Notes will depend on the status of the partner and the activities of the

partnership. Prospective purchasers that are treated as partnerships for U.S. federal income tax purposes should consult their tax advisers concerning the U.S. federal income tax consequences to them and their partners of the acquisition, ownership and disposition of Notes by the partnership.

The summary is based on the tax laws of the United States, including the Code, its legislative history, existing and proposed regulations thereunder, published rulings and court decisions, all as of the date hereof and all subject to change at any time, possibly with retroactive effect.

The Issuer expects, and this summary assumes, that the Notes will have an issue price equal to their stated redemption price at maturity or will be issued with no more than a de minimis amount of original issue discount ("OID"), and, as such, assumes that the Notes will be considered to be issued without OID.

THE SUMMARY OF U.S. FEDERAL INCOME TAX CONSEQUENCES SET OUT BELOW IS FOR GENERAL INFORMATION ONLY. ALL PROSPECTIVE PURCHASERS SHOULD CONSULT THEIR TAX ADVISERS AS TO THE PARTICULAR TAX CONSEQUENCES TO THEM OF OWNING THE NOTES, INCLUDING THE APPLICABILITY AND EFFECT OF STATE, LOCAL, NON-U.S. AND OTHER TAX LAWS AND POSSIBLE CHANGES IN TAX LAW.

Tax Consequences to U.S. Holders

For purposes of this discussion, a "U.S. Holder" is a beneficial owner of Notes that is, for U.S. federal income tax purposes, (i) an individual citizen or resident of the United States, (ii) a corporation created or organized under the laws of the United States, any state thereof or the District of Columbia (iii) an estate the worldwide income of which is subject to U.S. federal income tax without regard to its source or (iv) a trust if a court within the United States is able to exercise primary supervision over the administration of the trust and one or more U.S. persons have the authority to control all substantial decisions of the trust, or the trust has elected to be treated as a domestic trust for U.S. federal income tax purposes.

Payments of Interest

Interest on a Note will be taxable to a U.S. Holder as ordinary income at the time it is received or accrued, depending on such holder's method of accounting for U.S. federal income tax purposes.

Sale, Redemption, Retirement or Other Taxable Disposition of the Notes

A U.S. Holder generally will recognize gain or loss on the sale, redemption, retirement or other taxable disposition of a Note equal to the difference between (i) the sum of the amount of cash and the fair market value of any property received (but not including any amount attributable to accrued but unpaid interest, which will be taxable as interest income to the extent not previously included in income) and (ii) the U.S. Holder's tax basis in the Note. A U.S. Holder's tax basis in a Note generally will be the U.S. Holder's cost of the Note. A U.S. Holder's gain or loss will generally be capital gain or loss, and will be long-term capital gain or loss if the U.S. Holder held the Note for more than one year. A U.S. Holder's ability to deduct capital losses may be limited.

Backup Withholding and Information Reporting

Under the tax rules concerning backup withholding and information reporting to the Internal Revenue Service ("IRS"):

- Assuming a U.S. Holder holds the Notes through a broker or other securities intermediary, the intermediary must provide information to the IRS or to such U.S. Holder on IRS Form 1099 concerning interest and proceeds from the disposition of the Notes, unless an exemption applies.
- Similarly, unless an exemption applies, a U.S. Holder must provide the intermediary with such U.S. Holder's taxpayer identification number (typically on IRS Form W-9) for its use in reporting information to the IRS. If a U.S. Holder is an individual, this is such U.S. Holder's social security number. A U.S. Holder is also required to comply with other IRS requirements concerning information reporting.
- If a U.S. Holder is subject to these requirements but does not comply, the intermediary must withhold at a rate of 28% of all amounts payable to such U.S. Holder on the Notes (including principal payments and proceeds from a disposition) unless an exception applies. This is called "backup withholding." In addition, a U.S. Holder may in certain circumstances be subject to penalties imposed by the IRS. If the intermediary withholds on payments, a U.S. Holder may use the withheld amount as a credit against such U.S. Holder's U.S. federal income tax liability, provided that such U.S. Holder timely furnishes certain required information to the IRS.

- All U.S. Holders that are individuals are subject to these requirements. Some U.S. Holders, including all corporations, tax-exempt organizations and individual retirement accounts, are generally exempt from these requirements.

Tax Consequences to Non-U.S. Holders

For purposes of this discussion, a "Non-U.S. Holder" is a beneficial owner of Notes that is neither a U.S. Holder nor a partnership for U.S. federal income tax purposes.

Withholding Taxes

Generally, payments of principal and interest on the Notes will not be subject to U.S. withholding taxes.

However, in the case of interest, for an exemption from U.S. withholding taxes to apply, a Non-U.S. Holder must meet one of the following requirements:

- The Non-U.S. Holder provides, under penalties of perjury, a completed and accurate IRS Form W-8BEN or IRS Form W-8BEN-E, as applicable (or successor form), to the bank, broker or other intermediary through which the Non-U.S. Holder holds the Notes. The IRS Form W-8BEN or IRS Form W-8BEN-E, as applicable, must contain the Non-U.S. Holder's name, address, a statement that the Non-U.S. Holder is the beneficial owner of the Notes and that the Non-U.S. Holder is not a U.S. person, and that the payments are not effectively connected with the conduct of the Non-U.S. Holder's trade or business in the United States (or, where a tax treaty applies, are not attributable to a U.S. permanent establishment).
- The Non-U.S. Holder holds the Notes directly through a "qualified intermediary," and the qualified intermediary has sufficient information indicating that the Non-U.S. Holder is not a U.S. person. A qualified intermediary is a bank, broker or other intermediary that (i) is either a U.S. or non-U.S. entity, (ii) is acting out of a non-U.S. branch or office and (iii) has signed an agreement with the IRS providing that it will administer all or part of the U.S. tax withholding rules under specified procedures.
- The Non-U.S. Holder is entitled to an exemption from U.S. withholding tax on interest under a tax treaty between the United States and the Non-U.S. Holder's country of residence. To claim this exemption, the Non-U.S. Holder generally must complete IRS Form W-8BEN or IRS Form W-8BEN-E, as applicable, and claim this exemption on the form. In some cases, the Non-U.S. Holder may instead be permitted to provide documentary evidence of the claim to the intermediary, or a qualified intermediary may already have some or all of the necessary evidence.
- The interest income on the Notes is effectively connected with the conduct of the Non-U.S. Holder's trade or business in the United States, is not exempt from U.S. tax under a tax treaty, and if required by the applicable treaty, is attributable to a U.S. permanent establishment the Non-U.S. Holder maintains in the United States. To claim this exemption, the Non-U.S. Holder must complete IRS Form W-8ECI. In this case, the interest income will generally be subject to U.S. federal income tax as described under "*— U.S. Trade or Business.*"

Even if a Non-U.S. Holder meets one of the above requirements, interest paid to such Non-U.S. Holder will be subject to U.S. withholding tax at a rate of 30% under any of the following circumstances:

- The withholding agent or an intermediary knows or has reason to know that the Non-U.S. Holder is not entitled to an exemption from withholding tax. Specific rules apply for this test.
- The IRS notifies the withholding agent that information that the Non-U.S. Holder or an intermediary provided concerning the Non-U.S. Holder's status is false.
- An intermediary through which the Non-U.S. Holder holds the Notes fails to comply with the procedures necessary to avoid U.S. withholding taxes on the Notes. In particular, an intermediary is generally required to forward a copy of the Non-U.S. Holder's IRS Form W-8BEN or IRS Form W-8BEN-E, as applicable (or other documentation information concerning the Non-U.S. Holder's status), to the withholding agent for the Notes. However, if the Non-U.S. Holder holds the Notes through a qualified intermediary — or if there is a qualified intermediary in the chain of title between the Non-U.S. Holder and the withholding agent for the Notes — the qualified intermediary is not generally required to forward this information to the withholding agent in order to avoid U.S. withholding tax on payments of interest on the Notes.
- The Non-U.S. Holder owns, actually or constructively, 10% or more of the total combined voting power of all equity interests of the Issuer or is a "controlled foreign corporation" related directly or

indirectly to the Issuer through equity ownership. In these cases, the Non-U.S. Holder will be exempt from U.S. withholding taxes only if (i) the Non-U.S. Holder is eligible for a treaty exemption or if the interest income is effectively connected with the conduct of the Non-U.S. Holder's trade or business in the United States, and (ii) the Non-U.S. Holder provides the payor with a properly executed IRS Form W-8BEN, W-8BEN-E or W-8ECI, as discussed above.

Interest payments made to a Non-U.S. Holder will generally be reported to the IRS and to such Non-U.S. Holder. However, this reporting does not apply if a Non-U.S. Holder holds the Notes directly through a qualified intermediary and the applicable procedures are complied with.

The rules regarding withholding are complex and vary depending on Non-U.S. Holders' particular circumstances. Non-U.S. Holders should consult their tax advisers about the specific methods for satisfying these requirements.

Sale, Redemption, Retirement and Other Taxable Disposition of the Notes

A Non-U.S. Holder will not be subject to U.S. federal income or withholding tax on any gain on the sale, redemption, retirement or other taxable disposition of a Note unless one of the following applies:

- the gain is effectively connected with a trade or business that the Non-U.S. Holder conducts in the United States (and, where a tax treaty applies, is attributable to a U.S. permanent establishment);
- the Non-U.S. Holder is an individual that is present in the United States for at least 183 days during a period relevant to the taxable year in which the Non-U.S. Holder disposes of the Notes, and certain other conditions are satisfied; or
- the gain represents accrued interest, in which case the rules for interest (described above under "— *Withholding Taxes*") would apply.

U.S. Trade or Business

If a Non-U.S. Holder holds the Notes in connection with a trade or business that the Non-U.S. Holder conducts in the United States (and, where a tax treaty applies, the Notes are attributable to a U.S. permanent establishment):

- Any interest on the Notes, and any gain from disposing of the Notes, generally will be subject to U.S. federal income tax as if the Non-U.S. Holder were a U.S. person.
- If the Non-U.S. Holder is a corporation, the Non-U.S. Holder may be subject to the "branch profits tax" on the Non-U.S. Holder's earnings that are connected with the Non-U.S. Holder's U.S. trade or business, including earnings from the Notes. This tax rate is 30%, but may be reduced or eliminated by an applicable income tax treaty.

Backup Withholding and Information Reporting

U.S. rules concerning information reporting and backup withholding are described above. These rules apply to Non-U.S. Holders as follows:

- Principal and interest payments a Non-U.S. Holder receives will be automatically exempt from the usual rules if such Non-U.S. Holder is exempt from U.S. withholding tax on interest, as described above. The exemption does not apply if the withholding agent or an intermediary knows or has reason to know that the Non-U.S. Holder should be subject to the usual information reporting or backup withholding rules. In addition, as described above, interest payments made to a Non-U.S. Holder may be reported to the IRS.
- Proceeds a Non-U.S. Holder receives on a disposition of the Notes through a broker may be subject to information reporting and/or backup withholding if an exemption does not apply. In particular, information reporting and backup reporting may apply if the Non-U.S. Holder uses the U.S. office of a broker, and information reporting (but not backup withholding) may apply if the Non-U.S. Holder uses the foreign office of a broker that has certain connections to the United States. In general, a Non-U.S. Holder may provide IRS Form W-8BEN or IRS Form W-8BEN-E, as applicable, to claim an exemption from information reporting and backup withholding.

Non-U.S. Holders should consult their tax advisers about these rules.

FATCA

A 30% U.S. federal withholding tax may apply to interest income paid on the Notes and, after December 31, 2018, to the gross proceeds from a disposition of such Notes (including a repayment of principal), in each case

paid to (i) a "foreign financial institution" (as specifically defined in the Code), whether such foreign financial institution is the beneficial owner or an intermediary, unless such foreign financial institution agrees to verify, report and disclose its "United States account" holders (as specifically defined in the Code) and meets certain other specified requirements or (ii) a "non-financial foreign entity" (as specifically defined in the Code), whether such non-financial foreign entity is the beneficial owner or an intermediary, unless such entity provides a certification that the beneficial owner of the payment does not have any substantial U.S. owners or provides the name, address and taxpayer identification number of each substantial U.S. owner and certain other specified requirements are met. In certain cases, the relevant foreign financial institution or non-financial foreign entity may qualify for an exemption from, or be deemed to be in compliance with, these rules. Intergovernmental agreements between the U.S. and certain other countries may modify the foregoing rules. Holders should consult their tax advisers regarding the applicability of these rules to the ownership of the Notes.

Exchange Offer or Shelf Registration

In certain circumstances (see "*Registration Rights Agreement*"), we may be obligated to exchange the Notes for registered notes. Alternatively, or in addition to the Exchange Offer, under certain circumstances, we may be obligated to file with the SEC a shelf registration statement to cover certain resales of the Notes. The exchange of Notes for registered notes pursuant to the Exchange Offer or shelf registration statement should not constitute a taxable event for U.S. federal income tax purposes.

Accordingly, a holder of Notes should not recognize gain or loss as a result of the exchange of Notes for registered notes pursuant to the Exchange Offer, the holding period of the registered Notes should include the holding period of the Notes surrendered in exchange therefor and a holder's adjusted tax basis in the registered notes should be the same as such holder's adjusted tax basis in the Notes surrendered in exchange therefor. If we file a shelf registration statement covering the Notes, no gain or loss should be recognized by a holder and such holder's adjusted tax basis in, and holding period for, the Notes should also be unaffected.

Material Netherlands Income Tax Considerations

This section provides a general description of certain Dutch tax consequences of the acquisition, ownership and transfer of the Notes issued by the Issuer and guaranteed by the Guarantors, including the Dutch Guarantors.

This summary provides general information only and is restricted to the matters of Dutch taxation stated herein. It is intended neither as tax advice nor as a comprehensive description of all Dutch tax considerations that may be relevant to a decision to acquire, to hold, or to transfer the Notes. This summary does not purport to deal with the tax consequences applicable to all categories of investors, some of which (such as investment institutions, pension funds and dealers in securities) may be subject to special rules.

The summary provided below is based on the tax laws of The Netherlands as in effect on the date of this Offering Memorandum, including regulations, rulings and decisions of The Netherlands and its taxing and other authorities available in printed form on or before this date and now in effect, and as generally applied and interpreted by Dutch courts, without prejudice to any changes in law or the interpretation or application thereof, which changes may be implemented with or without retroactive effect. All references in this section to The Netherlands and Dutch tax, taxation or law are to the European part of the Kingdom of The Netherlands and its tax, taxation or law, respectively, only.

For Netherlands tax purposes, a Noteholder may include an individual who, or an entity that, does not have the legal title to the Notes, but to whom nevertheless the Notes are attributed based either on such individual or entity holding a beneficial interest in the Notes or based on specific statutory provisions, including statutory provisions pursuant to which the Notes are attributed to an individual who is, or who has directly or indirectly inherited from a person who was, the settlor, grantor or similar originator of a trust, foundation or similar entity that holds the Notes.

Noteholders (and prospective Noteholders) should consult their own tax advisors as to the Dutch or other tax consequences of the acquisition, ownership and transfer of Notes, including, in particular, the application to their particular situations of the tax considerations discussed below.

Withholding Tax

All payments made by either of the Issuer or, as the case may be, the Guarantors of interest and principal under the Notes may be made free of withholding or deduction of any taxes of whatever nature imposed, levied, withheld or assessed by The Netherlands or any political subdivision or taxing authority thereof or therein.

Taxes on Income and Capital Gains

A Noteholder who derives income from a Note or who realizes a gain from the transfer or redemption of a Note will not be subject to Dutch taxation on such income or gain, provided that such Noteholder:

(i) is neither resident nor deemed to be resident in The Netherlands for Dutch tax purposes;

(ii) does not have an enterprise or deemed enterprise (as defined in Dutch tax law) or an interest in or a co-entitlement to the net worth of an enterprise or deemed enterprise (as defined in Dutch tax law) that is, in whole or in part, carried on through a permanent establishment (*vaste inrichting*) or a permanent representative (*vaste vertegenwoordiger*) in The Netherlands and to which enterprise or part of that enterprise, as the case may be, the Notes are attributable;

(iii) in the event such person is not an individual, neither entitled to a share in the profits of an enterprise effectively managed in The Netherlands nor co-entitled to the net worth of such enterprise, other than by way of the holding of securities, to which enterprise the Notes or payments in respect of the Notes are attributable;

(iv) in the event such person who is an individual, is not entitled to a share in the profits of an enterprise effectively managed in The Netherlands, other than by way of the holding of securities or through an employment contract, to which enterprise the Notes or payments in respect of the Notes are attributable;

(v) in the event such person is an individual, does not have, and certain persons related or deemed related to that Noteholder do not have, directly or indirectly, a substantial interest (*aanmerkelijk belang*) as defined in the Dutch Income Tax Act 2001 (*Wet inkomstenbelasting 2001*), in an Issuer or Guarantor, or in any company that has, or that is part of a co-operation (*samenwerkingsverband*) that has, legally or in fact, directly or indirectly, the disposition of any part of the proceeds of the Notes;

(vi) in the event such person is not an individual, does not have, directly or indirectly, a substantial interest (*aanmerkelijk belang*) as defined in the Dutch Income Tax Act 2001, in an Issuer or Guarantor, or, in the event that the Noteholder does have such interest, either (a) the Noteholder does not hold such interest with the main purpose or one of the main purposes to avoid the levy of income tax (*inkomstenbelasting*) or dividend withholding tax (*dividendbelasting*) of another person or entity, or (b) there is no arrangement or a series of arrangements that are not genuine. An arrangement or series of arrangements shall be regarded as not genuine to the extent not put into place for valid commercial reasons which reflect economic reality; and

(vii) does not derive benefits from the Notes that are taxable as benefits from miscellaneous activities in The Netherlands (*resultaat uit overige werkzaamheden in Nederland)* as defined in the Dutch Income Tax Act 2001, which include, but are not limited to, activities in respect of the Notes which are beyond the scope of "regular active asset management" (*normaal actief vermogensbeheer*).

Gift and Inheritance Taxes

No Dutch gift or inheritance taxes will arise in The Netherlands with respect to the acquisition of the Notes by way of gift by, or on the death of, a Noteholder who is neither resident nor deemed to be resident in The Netherlands for the purpose of the relevant provisions, unless:

(i) such acquisition is construed as an inheritance, a bequest or a gift by or on behalf of a person who, at the time of the gift or his death, is or was a resident or a deemed resident of The Netherlands for the purpose of the relevant provisions;

(ii) in the case of a gift of the Notes by an individual who at the date of the gift was neither resident nor deemed to be resident in The Netherlands, such individual dies within 180 days after the date of the gift, while being resident or deemed to be resident in The Netherlands; or

(iii) the gift is made under a condition precedent and such holder is or is deemed to be a resident of The Netherlands at the time the condition is fulfilled.

For the purpose of Dutch gift and inheritance tax, an individual who has the Dutch nationality will be deemed to be a resident of The Netherlands at the date of the gift or the date of his death if he has been a resident of The Netherlands at any time during the ten years preceding the date of the gift or the date of his death.

For the purposes of Dutch gift tax, an individual will, irrespective of his nationality, be deemed to be a resident of The Netherlands at the date of the gift if he has been a resident of The Netherlands at any time during the 12 months preceding the date of the gift.

Value added Tax

No Dutch value added tax (*omzetbelasting*) will be payable by a Noteholder in consideration for the issue of the Notes (other than value added taxes on fees payable in respect of services not exempt from Netherlands value added tax).

Other taxes and duties

No Dutch registration tax, stamp duty or any other similar tax or duty, will be payable in The Netherlands by a Noteholder in respect of or in connection with the acquisition, ownership or transfer of the Notes.

Residence

A Noteholder will not become or be deemed to become a resident of The Netherlands for tax purposes by reason only of the acquisition, ownership or transfer of the Notes.

CERTAIN ERISA CONSIDERATIONS

The following is a summary of certain considerations associated with the purchase of the Notes by employee benefit plans that are subject to Title I of the U.S. Employee Retirement Income Security Act of 1974, as amended ("ERISA"); plans, individual retirement accounts and other arrangements that are subject to Section 4975 of the Code or provisions under any other federal, state, local, non-U.S. or other laws or regulations that are similar to such provisions of the Code or ERISA (collectively, "Similar Laws"), and entities whose underlying assets are considered to include "plan assets" of any such employee benefit plan, plan, account or arrangement (each, a "Plan").

General Fiduciary Matters

ERISA and the Code impose certain duties on persons who are fiduciaries of a Plan subject to Title I of ERISA or Section 4975 of the Code (an "ERISA Plan") and prohibit certain transactions involving the assets of an ERISA Plan and its fiduciaries or other interested parties. Under ERISA and the Code, any person who exercises any discretionary authority or control over the administration of such an ERISA Plan or the management or disposition of the assets of such an ERISA Plan, or who renders investment advice for a fee or other compensation to such an ERISA Plan, is generally considered to be a fiduciary of the ERISA Plan.

In considering an investment in the Notes of a portion of the assets of any Plan, a fiduciary should determine whether the investment is in accordance with the documents and instruments governing the Plan and the applicable provisions of ERISA, the Code or any Similar Law relating to a fiduciary's duties to the Plan, including, without limitation, the prudence, diversification, delegation of control and prohibited transaction provisions of ERISA, the Code and any other applicable Similar Laws. In addition, a fiduciary of a Plan should consult with its counsel in order to determine if the investment satisfies the fiduciary's duties to the Plan, including, without limitation, the prudence, diversification, delegation of control and prohibited transaction provisions of ERISA, the Code and any other applicable Similar Laws.

Prohibited Transaction Issues

Section 406 of ERISA and Section 4975 of the Code prohibit ERISA Plans from engaging in specified transactions involving plan assets with persons or entities who are "parties in interest," within the meaning of ERISA, or "disqualified persons," within the meaning of Section 4975 of the Code, unless an exemption is available. A party in interest or disqualified person who engaged in a non-exempt prohibited transaction may be subject to excise taxes and other penalties and liabilities under ERISA and the Code. In addition, the fiduciary of the ERISA Plan that engaged in such a non-exempt prohibited transaction may be subject to penalties and liabilities under ERISA and the Code. The acquisition and/or holding of the Notes by an ERISA Plan with respect to which any of the Issuer, Guarantors or Initial Purchasers or any of their respective affiliates is considered a party in interest or a disqualified person may constitute or result in a direct or indirect prohibited transaction under Section 406 of ERISA and/or Section 4975 of the Code, unless the investment is acquired and is held in accordance with an applicable statutory, class or individual prohibited transaction exemption. Each of these exemptions contains conditions and limitations on its application, and there can be no assurance that all of the conditions will be satisfied. Therefore, each person that is considering acquiring or holding the Notes in reliance on an exemption should carefully review and consult with its legal advisors to confirm that it is applicable to the purchase and holding of the Notes.

In light of the above, the Notes should not be purchased or held by any person investing "plan assets" of any Plan, unless such purchase and holding will not constitute or result in a non-exempt prohibited transaction under ERISA or the Code or violate any applicable Similar Laws.

Representation

Accordingly, by acceptance of a Note, each purchaser, holder and subsequent transferee of a Note will be deemed to have represented and warranted that either (i) no portion of the assets used by such purchaser, holder or transferee to acquire or hold the Notes, or any interest therein, constitutes assets of any Plan or (ii) the purchase, holding and subsequent disposition of the Notes by such purchaser, holder or transferee will not constitute or result in a non-exempt prohibited transaction under Section 406 of ERISA or Section 4975 of the Code or violate any applicable Similar Laws. In addition, each purchaser that is purchasing or holding a Note on behalf of an ERISA Plan will be deemed to have represented and warranted that the purchaser (i) is an independent fiduciary to the ERISA Plan and is responsible for exercising independent judgment in evaluating the decision to purchase the Notes on behalf of the ERISA Plan, (ii) is a bank, insurance carrier, investment adviser or broker-dealer described in 29 CFR § 2510.3 — 21(c)(1)(A), (B), (C) or (D) or holds or has under management total assets of at least $50 million, (iii) is capable of evaluating investment risks independently, both

in general and with regard to the purchase and holding of the Notes and (iv) understands and has been fairly informed of the financial interests of the Issuer, Guarantors and Initial Purchasers in connection with the purchase and holding of the Notes.

The foregoing discussion is general in nature and is not intended to be all inclusive. Due to the complexity of these rules and the penalties that may be imposed upon persons involved in non-exempt prohibited transactions, it is particularly important that fiduciaries, or other persons considering purchasing the Notes on behalf of, or with the assets of, any Plan, consult with their counsel regarding the potential applicability of ERISA, Section 4975 of the Code and any Similar Laws to such investment and whether an exemption would be applicable to the purchase and holding of the Notes.

Purchasers of the Notes have the exclusive responsibility for ensuring that their purchase and holding of the Notes complies with the fiduciary responsibility rules of ERISA or of applicable Similar Laws and does not violate the prohibited transaction rules of ERISA, the Code or applicable Similar Laws. We make no representation as to whether an investment in the Notes is appropriate for any Plan in general or whether such investment is appropriate for any particular plan or arrangement. Neither this discussion nor anything provided in this Offering Memorandum is or is intended to be investment advice directed at any potential Plan purchaser or at Plan purchasers generally and such purchasers of the Notes should consult and rely on their own counsel and advisers as to whether an investment in the Notes is suitable.

PLAN OF DISTRIBUTION

Pursuant to a Purchase Agreement dated August 8, 2017 (the "Purchase Agreement"), the Initial Purchasers have severally agreed with the Issuer and each of the Guarantors, subject to the satisfaction of certain conditions, to purchase $2,250,000,000 principal amount of the 2020 Fixed Rate Notes, $2,250,000,000 principal amount of the 2022 Fixed Rate Notes, $2,500,000,000 principal amount of the 2024 Fixed Rate Notes, $3,500,000,000 principal amount of the 2027 Fixed Rate Notes, $2,500,000,000 principal amount of the 2037 Fixed Rate Notes, $2,500,000,000 principal amount of the 2047 Fixed Rate Notes, $1,000,000,000 principal amount of the 2020 Floating Rate Notes and $750,000,000 principal amount of the 2022 Floating Rate Notes. The respective principal amount of Notes to be purchased by each of the Initial Purchasers from the Issuer and the Guarantors is set forth opposite their respective names below.

	Principal Amount of 2020 Fixed Rate Notes	Principal Amount of 2022 Fixed Rate Notes	Principal Amount of 2024 Fixed Rate Notes	Principal Amount of 2027 Fixed Rate Notes	Principal Amount of 2037 Fixed Rate Notes	Principal Amount of 2047 Fixed Rate Notes	Principal Amount of 2020 Floating Rate Notes	Principal Amount of 2022 Floating Rate Notes
Merrill Lynch, Pierce, Fenner & Smith Incorporated	$ 180,225,000	$ 180,225,000	$ 200,250,000	$ 280,350,000	$ 200,250,000	$ 200,250,000	$ 80,100,000	$ 60,075,000
Barclays Capital Inc.	$ 180,225,000	$ 180,225,000	$ 200,250,000	$ 280,350,000	$ 200,250,000	$ 200,250,000	$ 80,100,000	$ 60,075,000
Citigroup Global Markets Inc.	$ 180,225,000	$ 180,225,000	$ 200,250,000	$ 280,350,000	$ 200,250,000	$ 200,250,000	$ 80,100,000	$ 60,075,000
Deutsche Bank Securities Inc.	$ 180,225,000	$ 180,225,000	$ 200,250,000	$ 280,350,000	$ 200,250,000	$ 200,250,000	$ 80,100,000	$ 60,075,000
HSBC Securities (USA) Inc.	$ 180,225,000	$ 180,225,000	$ 200,250,000	$ 280,350,000	$ 200,250,000	$ 200,250,000	$ 80,100,000	$ 60,075,000
Mizuho Securities USA LLC	$ 126,675,000	$ 126,675,000	$ 140,750,000	$ 197,050,000	$ 140,750,000	$ 140,750,000	$ 56,300,000	$ 42,225,000
RBS Securities Inc. (marketing name "NatWest Markets")	$ 126,675,000	$ 126,675,000	$ 140,750,000	$ 197,050,000	$ 140,750,000	$ 140,750,000	$ 56,300,000	$ 42,225,000
Santander Investment Securities Inc.	$ 126,675,000	$ 126,675,000	$ 140,750,000	$ 197,050,000	$ 140,750,000	$ 140,750,000	$ 56,300,000	$ 42,225,000
SMBC Nikko Securities America, Inc.	$ 126,675,000	$ 126,675,000	$ 140,750,000	$ 197,050,000	$ 140,750,000	$ 140,750,000	$ 56,300,000	$ 42,225,000
Société Générale	$ 126,675,000	$ 126,675,000	$ 140,750,000	$ 197,050,000	$ 140,750,000	$ 140,750,000	$ 56,300,000	$ 42,225,000
Bank of China Limited London Branch.	$ 97,200,000	$ 97,200,000	$ 108,000,000	$ 151,200,000	$ 108,000,000	$ 108,000,000	$ 43,200,000	$ 32,400,000
BBVA Securities Inc.	$ 97,200,000	$ 97,200,000	$ 108,000,000	$ 151,200,000	$ 108,000,000	$ 108,000,000	$ 43,200,000	$ 32,400,000
Commerz Markets LLC	$ 97,200,000	$ 97,200,000	$ 108,000,000	$ 151,200,000	$ 108,000,000	$ 108,000,000	$ 43,200,000	$ 32,400,000
ING Financial Markets LLC	$ 97,200,000	$ 97,200,000	$ 108,000,000	$ 151,200,000	$ 108,000,000	$ 108,000,000	$ 43,200,000	$ 32,400,000
Lloyds Securities Inc.	$ 97,200,000	$ 97,200,000	$ 108,000,000	$ 151,200,000	$ 108,000,000	$ 108,000,000	$ 43,200,000	$ 32,400,000
Scotia Capital (USA) Inc.	$ 97,200,000	$ 97,200,000	$ 108,000,000	$ 151,200,000	$ 108,000,000	$ 108,000,000	$ 43,200,000	$ 32,400,000
UniCredit Bank AG	$ 97,200,000	$ 97,200,000	$ 108,000,000	$ 151,200,000	$ 108,000,000	$ 108,000,000	$ 43,200,000	$ 32,400,000
Standard Chartered Bank	$ 35,100,000	$ 35,100,000	$ 39,000,000	$ 54,600,000	$ 39,000,000	$ 39,000,000	$ 15,600,000	$ 11,700,000
Total	**$2,250,000,000**	**$2,250,000,000**	**$2,500,000,000**	**$3,500,000,000**	**$2,500,000,000**	**$2,500,000,000**	**$1,000,000,000**	**$750,000,000**

The Purchase Agreement entitles the Initial Purchasers to terminate the purchase of the Notes in certain circumstances prior to payment to the Issuer. The Issuer and each of the Guarantors have agreed to indemnify the Initial Purchasers against certain liabilities in connection with the offer and sale of the Notes and may be required to contribute to payments that the Initial Purchasers may be required to make in respect thereof.

The Initial Purchasers initially propose to offer the Notes at the issue prices set forth on the cover page hereof. After the initial offering of the Notes, the issue prices may from time to time be varied by the Initial Purchasers.

The Issuer and each of the Guarantors have agreed with the Initial Purchasers that none of them and no person acting on their behalf will without the prior written consent of Merrill Lynch, Pierce, Fenner & Smith Incorporated, Barclays Capital Inc., Citigroup Global Markets Inc., Deutsche Bank Securities Inc. and HSBC Securities (USA) Inc. (the "Representatives") for the period from and including the date of the Purchase Agreement through and including the closing date, offer, sell, contract to sell or otherwise dispose of any debt securities (other than short-term debt securities) of or guaranteed by the Issuer or Guarantors which are substantially similar to the Notes.

The Notes are new issues of securities with no established trading market. The Notes are expected to be admitted to the Official List of the UK Listing Authority and to trading on the PSM. The Initial Purchasers are not obligated to make a market in the Notes and accordingly, no assurance can be given as to the liquidity of, or trading market for, the Notes. In connection with the offering, the Representatives may purchase and sell Notes in the open market. These transactions may include over-allotment, syndicate covering transactions and stabilizing transactions. Over-allotment involves syndicate sales of notes in excess of the principal amount of the Notes to be purchased by the Representatives in the offering, which creates a syndicate short position. Syndicate covering transactions involve purchases of the Notes in the open market after the distribution has been completed

in order to cover syndicate short positions. Stabilizing transactions consist of certain bids or purchases of Notes made for the purpose of pegging, fixing or maintaining the price of the Notes.

The Representatives may impose a penalty bid. Penalty bids permit the Representatives to reclaim selling concessions from a syndicate member when they, in covering syndicate positions or making stabilizing purchases, repurchase Notes originally sold by that syndicate member.

Any of these activities may cause the price of the Notes to be higher than the price that otherwise would exist in the open market in the absence of such transactions. These transactions may be effected in the over-the-counter market or otherwise and, if commenced, may be discontinued at any time at the sole discretion of the Representatives, as applicable.

No action has been or will be taken in any jurisdiction that would permit a public offering of the Notes or the possession, circulation or distribution of any material relating to the Issuer or Guarantors, in any jurisdiction where action for such purpose is required. Accordingly, the Notes may not be offered or sold, directly or indirectly, nor may any offering material or advertisement in connection with the Notes be distributed or published, in or from any country or jurisdiction, except under circumstances that will result in compliance with any applicable rules and regulations of any such country or jurisdiction.

The Initial Purchasers and their affiliates have performed certain investment and commercial banking or financial advisory services for us and our affiliates from time to time for which they have received customary fees and commissions, and they expect to provide these services to us and our affiliates in the future, for which they expect to receive customary fees and commissions. Affiliates of certain Initial Purchasers are lenders under the acquisition facility and, accordingly, they will receive a portion of the net proceeds of the offering of the Notes through the repayment of borrowings under the acquisition facility. In addition, in the ordinary course of their business activities, the Initial Purchasers and their affiliates may make or hold a broad array of investments and actively trade debt and equity securities (or related derivative securities) and financial instruments (including bank loans) for their own account and for the accounts of their customers. Such investments and securities activities may involve securities and/or instruments of ours or our affiliates. Certain of the Initial Purchasers or their affiliates that have a lending relationship with us routinely hedge their credit exposure to us consistent with their customary risk management policies. Typically, such Initial Purchasers and their affiliates would hedge such exposure by entering into transactions which consist of either the purchase of credit default swaps or the creation of short positions in our securities, including potentially the Notes offered hereby. Any such short positions could adversely affect future trading prices of the Notes offered hereby. The Initial Purchasers and their affiliates may also make investment recommendations and/or publish or express independent research views in respect of such securities or financial instruments and may hold, or recommend to clients that they acquire, long and/or short positions in such securities and instruments.

Lionel L. Nowell, III, an independent Non-Executive Director of British American Tobacco p.l.c., is also a Non-Executive Director of Bank of America Corporation, an affiliate of Merrill Lynch, Pierce, Fenner & Smith Incorporated, an Initial Purchaser.

To the extent any Initial Purchaser that is not a U.S. registered broker-dealer intends to effect any offers or sales of any Notes in the United States, it will do so through one or more U.S. registered broker-dealers in accordance with the applicable U.S. securities laws and regulations.

We expect that delivery of the Notes will be made against payment therefor on or about August 15, 2017, which will be the fifth business day following the date of pricing of the Notes, or "T+5." Trades in many secondary markets generally settle in three business days, unless the parties to any such trade expressly agree otherwise. Accordingly, purchasers who wish to trade Notes on the date of pricing or the next succeeding business day will be required, by virtue of the fact that the Notes initially settle in T+5, to specify an alternate settlement arrangement at the time of any such trade to prevent a failed settlement. Purchasers of the Notes who wish to trade the Notes prior to their date of delivery hereunder should consult their advisors.

United States

The Notes have not been registered under the Securities Act and may not be offered or sold within the United States or to, or for the account or benefit of, U.S. persons except in certain transactions exempt from the registration requirements of the Securities Act. Accordingly, the Notes are being offered and sold only to (i) QIBs within the United States in accordance with Rule 144A and (ii) non-U.S. persons located outside the United States in reliance on Regulation S under the Securities Act.

In connection with sales outside of the United States, each Initial Purchaser has represented and agreed with the Issuer and each of the Guarantors that, except as permitted by the Purchase Agreement, it will not offer, sell

or deliver the Notes to, or for the account or benefit of, U.S. persons, (i) as part of their distribution at any time or (ii) otherwise until and including the fortieth day after the later of the commencement of the offer and the closing date for the sale of any Notes pursuant to the Purchase Agreement, except in accordance with Rule 903 of Regulation S. Each Initial Purchaser has also agreed that it, each of its affiliates and each person acting on its or their behalf have complied and will comply with the offering restriction requirements of Regulation S; and at or prior to confirmation of a sale of Notes (other than a sale pursuant to Rule 144A, if permitted) it will have sent to each distributor, dealer or other person receiving a selling concession, fee or other remuneration to which it sells Notes during the distribution compliance period a confirmation or other notice setting forth the restrictions on offers and sales of the Notes within the United States or to, or for the account or benefit of U.S. persons. Each Initial Purchaser has also represented and agreed with the Issuer and each of the Guarantors that no directed selling efforts (as defined in Regulation S) have been made or will be made in the United States by the Initial Purchasers, any of their affiliates or any person acting on behalf of any of the Initial Purchasers or their affiliates in respect to the Notes; and neither it, any of its affiliates, nor anyone acting on its or their behalf has solicited offers for, offered or sold the Notes by any form of general solicitation or general advertising (as those terms are used in Regulation D under the Securities Act) in the United States in connection with the offering of the Notes or otherwise in any manner involving a public offering within the meaning of Section 4(2) of the Securities Act.

Terms used in the preceding two paragraphs have the meanings ascribed to them by Rule 144A and Regulation S under the Securities Act, as applicable.

In addition, until forty days after the commencement of the offering of the Notes, an offer or sale of Notes within the United States by any dealer (whether or not participating in the offering of the Notes) may violate the registration requirements of the Securities Act if such offer or sale is made otherwise than in accordance with Rule 144A under the Securities Act.

United Kingdom

Each Initial Purchaser has represented and agreed with the Issuer and each of the Guarantors that:

(i) it has only communicated or caused to be communicated and will only communicate or cause to be communicated an invitation or inducement to engage in investment activity (within the meaning of section 21 of the FSMA) received by it in connection with the issue or sale of the Notes in circumstances in which section 21(1) of the FSMA does not apply to the Issuer or the Guarantors; and

(ii) it has complied and will comply with all applicable provisions of the FSMA with respect to anything done by it in relation to the Notes in, from or otherwise involving the United Kingdom.

European Economic Area

In relation to each Member State of the European Economic Area which has implemented the Prospectus Directive (each, a "Relevant Member State"), each Initial Purchaser has represented and agreed with the Issuer and each of the Guarantors that with effect from and including the date on which the Prospectus Directive is implemented in that Relevant Member State it has not made and will not make an offer of Notes which are the subject of the offering contemplated by this Offering Memorandum to the public in that Relevant Member State other than:

(a) to any legal entity which is a qualified investor as defined in the Prospectus Directive;

(b) to fewer than 150, natural or legal persons (other than qualified investors as defined in the Prospectus Directive), subject to obtaining the prior consent of the relevant Representative or Representatives nominated by the Issuer for any such offer; or

(c) in any other circumstances falling within Article 3(2) of the Prospectus Directive,

provided that no such offer of Notes shall require any of the Issuer, the Guarantors or any of the Initial Purchasers to publish a prospectus pursuant to Article 3 of the Prospectus Directive.

For the purposes of this provision, the expression an "offer of Notes to the public" in relation to any Notes in any Relevant Member State means the communication in any form and by any means of sufficient information on the terms of the offer and the Notes to be offered so as to enable an investor to decide to purchase or subscribe the Notes, as the same may be varied in that Member State by any measure implementing the Prospectus Directive in that Member State, the expression "Prospectus Directive" means Directive 2003/71/EC (as amended, including by Directive 2010/73/EU) and includes any relevant implementing measure in the Relevant Member State.

Other

Each Initial Purchaser has represented and agreed with the Issuer and each of the Guarantors that it will, to the best of its knowledge, comply with all relevant laws, regulations and directives in each jurisdiction in which it purchases, offers, sells or delivers the Notes or has in its possession or distributes this Offering Memorandum or any amendment or supplement thereto, in so far as such laws, regulations and directives relate to the purchase, offer, sale or delivery of the Notes or the possession or distribution of this Offering Memorandum or any amendment or supplement thereto, and neither the Issuer nor the Guarantors shall have any responsibility therefor.

NOTICE TO INVESTORS

The following restrictions will apply to the Notes (including the Guarantees). Prospective investors are advised to consult legal counsel prior to making any offer, sale, resale, pledge or transfer of the Notes offered hereby.

The Notes and the Guarantees have not been registered under the Securities Act and may not be offered or sold within the United States or to, or for the account or benefit of, U.S. persons except pursuant to an exemption from, or in a transaction not subject to, the registration requirements of the Securities Act. Accordingly, the Notes and the Guarantees are being offered and sold only (i) within the United States to QIBs (as defined in Rule 144A), in reliance on the exemption from the registration requirements of the Securities Act provided by Rule 144A; and (ii) in offers and sales that occur outside the United States to purchasers who are not U.S. persons in reliance on Regulation S (terms used in this paragraph that are defined in Rule 144A or Regulation S under the Securities Act are used herein as defined therein).

In addition, until 40 days after the later of the commencement of the offering and the closing date an offer or sale of the Notes within the United States by a dealer (whether or not participating in the offering) may violate the registration requirements of the Securities Act if such offer or sale is made otherwise than pursuant to Rule 144A.

Until all Notes have been exchanged for notes registered under the Securities Act or a registration statement covering resales of the Notes under the Securities Act has been made available as described under "*Registration Rights Agreement*", the following U.S. restrictions will apply regardless of whether the Notes may otherwise be sold without registration under the Securities Act under Rule 144. Purchasers of the Notes in the United States are advised to consult legal counsel prior to making any purchase, offer, sale, resale or other transfer of such Notes.

By its purchase of Notes, each purchaser of Notes (other than the Initial Purchasers) will be deemed to:

1. Represent that it is not an "affiliate", as defined under Rule 144A, of the Issuer or the Guarantors or acting on their behalf and that it (A)(i) is purchasing the Notes for its own account or an account with respect to which it exercises sole investment discretion and that it, (ii) is a QIB, and (iii) is aware that the sale to it is being made in reliance on Rule 144A (and is acquiring such Notes for its own account or for the account of another QIB) or (B) is not a U.S. person and is purchasing the Notes in an offshore transaction pursuant to Regulation S.

2. Acknowledge and understand that the Notes (including the Guarantees) have not been registered under the Securities Act or any other applicable securities laws and that the Notes are being offered for resale in a transaction not requiring registration under the Securities Act or any other securities laws, and may not be offered or sold within the United States or to, or for the account or benefit of, U.S. persons except as set forth below.

3. Understand and agree that if in the future it decides to offer, resell, pledge or otherwise transfer any of the Notes (including the Guarantees) or any beneficial interest in the Notes, it will only do so (i) to the Issuer or the Guarantors or any of their respective subsidiaries, (ii) for so long as the Notes are eligible pursuant to Rule 144A under the Securities Act, in the United States to a person whom the seller reasonably believes is a QIB in a transaction meeting the requirements of Rule 144A, (iii) outside the United States in compliance with Rule 904 under the Securities Act, (iv) pursuant to another available exemption from registration under the Securities Act, (v) pursuant to an effective registration statement under the Securities Act, in each of cases (i) through (v) in accordance with any applicable securities laws of any state of the United States. Subject to the procedures set forth under "*Book Entry, Delivery and Form*", prior to any proposed transfer of any Note the holder thereof must check the appropriate box set forth on its Note relating to the manner of such transfer and submit the Note to the Transfer Agent.

4. Agree that it will deliver to each person to whom it transfers Notes notice of any restrictions on transfer of such Notes.

5. If it is not a U.S. person outside the United States, understand that the Notes offered under Regulation S will be represented by one or more Regulation S Global Notes, which will initially be restricted as described under "*Book Entry, Delivery and Form*" for a period ending 40 days after the later of the commencement of the offering and the closing date. If it is a QIB, it understands that the Notes offered in reliance on Rule 144A will be represented by two or more Rule 144A Global Notes (together with the Regulation S Global Notes, the "Global Notes"). Before any interest in the Global Notes may be offered, sold, pledged or otherwise transferred to a purchaser outside the United States in compliance with Rule 904 under the Securities Act, the transferor will be required to provide the Transfer Agent with a

written certificate (the form of which certification can be obtained from the Transfer Agent) as to compliance with the transfer restriction referred to above.

6. Understand that the Notes will, until the expiration of the applicable holding period with respect to the Notes set forth in Rule 144 of the Securities Act, unless otherwise agreed by the Issuer and holder thereof, bear a legend to the following effect unless otherwise agreed by the Issuer and the holder thereof:

"THIS SECURITY HAS NOT BEEN REGISTERED UNDER THE U.S. SECURITIES ACT OF 1933, AS AMENDED (THE "SECURITIES ACT"), OR OTHER SECURITIES LAWS OF ANY STATE OR OTHER JURISDICTION. NEITHER THIS SECURITY NOR ANY INTEREST OR PARTICIPATION HEREIN MAY BE OFFERED, SOLD, ASSIGNED, TRANSFERRED, PLEDGED, ENCUMBERED OR OTHERWISE DISPOSED OF IN THE ABSENCE OF SUCH REGISTRATION UNLESS THE TRANSACTION IS EXEMPT FROM, OR NOT SUBJECT TO, THE REGISTRATION REQUIREMENTS OF THE SECURITIES ACT.

ACCORDINGLY, THE SECURITIES MAY NOT BE OFFERED OR SOLD WITHIN THE UNITED STATES OR TO, OR FOR THE ACCOUNT OR BENEFIT OF, ANY PERSONS, EXCEPT AS SET FORTH IN THE FOLLOWING SENTENCE. THE HOLDER OF THIS SECURITY BY ITS ACCEPTANCE HEREOF (1) REPRESENTS THAT (A) IT IS A "QUALIFIED INSTITUTIONAL BUYER" (AS DEFINED IN RULE 144A UNDER THE SECURITIES ACT ("RULE 144A")) OR (B) IT IS NOT A U.S. PERSON AND IS ACQUIRING THIS SECURITY IN AN "OFFSHORE TRANSACTION" PURSUANT TO RULE 904 OF REGULATION S UNDER THE SECURITIES ACT ("REGULATION S"); (2) AGREES ON ITS OWN BEHALF AND ON BEHALF OF ANY INVESTOR ACCOUNT FOR WHICH IT HAS PURCHASED SECURITIES THAT IT WILL NOT PRIOR TO (A) THE DATE WHICH IS 40 DAYS IN THE CASE OF SECURITIES SOLD IN RELIANCE ON REGULATION S OR ONE YEAR (OR SUCH SHORTER PERIOD OF TIME AS PERMITTED BY RULE 144 UNDER THE SECURITIES ACT OR ANY SUCCESSOR PROVISION THEREUNDER) IN THE CASE OF SECURITIES SOLD IN RELIANCE ON RULE 144A AFTER THE LATER OF THE ORIGINAL ISSUE DATE HEREOF (OR OF ANY PREDECESSOR OF THIS SECURITY) OR THE LAST DAY ON WHICH THE ISSUER OR ANY AFFILIATE OF THE ISSUER WERE THE OWNERS OF THIS SECURITY (OR ANY PREDECESSOR OF THIS SECURITY) AND (B) SUCH LATER DATE, IF ANY, AS MAY BE REQUIRED BY APPLICABLE LAW (THE "RESALE RESTRICTION TERMINATION DATE"), OFFER, SELL OR OTHERWISE TRANSFER THIS SECURITY EXCEPT (i) TO THE ISSUER OR THE GUARANTORS OR ANY OF THEIR RESPECTIVE SUBSIDIARIES, (ii) FOR SO LONG AS THE SECURITIES ARE ELIGIBLE FOR RESALE PURSUANT TO RULE 144A, IN THE UNITED STATES TO A PERSON WHOM THE SELLER REASONABLY BELIEVES IS A QUALIFIED INSTITUTIONAL BUYER IN COMPLIANCE WITH RULE 144A UNDER THE SECURITIES ACT, (iii) OUTSIDE THE UNITED STATES IN AN OFFSHORE TRANSACTION IN COMPLIANCE WITH RULE 904 UNDER THE SECURITIES ACT, (iv) PURSUANT TO ANOTHER AVAILABLE EXEMPTION FROM REGISTRATION UNDER THE SECURITIES ACT, OR (v) PURSUANT TO AN EFFECTIVE REGISTRATION STATEMENT UNDER THE SECURITIES ACT, AND IN EACH OF SUCH CASES IN COMPLIANCE WITH ANY APPLICABLE SECURITIES LAW IN ANY STATE OF THE UNITED STATES; (3) AGREES THE NOTES HAVE NOT BEEN OFFERED TO IT BY MEANS OF ANY DIRECTED SELLING EFFORTS AS DEFINED IN REGULATION S; AND (4) AGREES THAT IT WILL DELIVER TO EACH PERSON TO WHOM THIS SECURITY IS TRANSFERRED A NOTICE SUBSTANTIALLY TO THE EFFECT OF THIS LEGEND. IN CONNECTION WITH ANY TRANSFER OF THIS SECURITY WITHIN ONE YEAR AFTER THE LATER OF THE ORIGINAL ISSUANCE OF THIS SECURITY AND THE LAST DATE ON WHICH THIS SECURITY WAS HELD BY THE ISSUER, THE TRUSTEE OR ANY AFFILIATE OF SUCH PERSONS, THE HOLDER MUST CHECK THE APPROPRIATE BOX SET FORTH ON THE REVERSE HEREOF RELATING TO THE MANNER OF SUCH TRANSFER AND SUBMIT THIS SECURITY TO THE TRANSFER AGENT. THE INDENTURE CONTAINS PROVISIONS REQUIRING THE TRANSFER AGENT TO REFUSE TO REGISTER ANY TRANSFER OF THIS SECURITY IN VIOLATION OF THE FOREGOING RESTRICTIONS. AS USED HEREIN, THE TERMS "OFFSHORE TRANSACTION", "UNITED STATES" AND "U.S. PERSON" HAVE THE MEANINGS GIVEN TO THEM BY REGULATION S UNDER THE SECURITIES ACT".

7. Represent and agree that: (i) it has only communicated or caused to be communicated and will only communicate or cause to be communicated an invitation or inducement to engage in investment activity (within the meaning of section 21 of the FSMA) received by it in connection with the issue or sale of the Notes in circumstances in which section 21(1) of the FSMA does not apply to the Issuer; and (ii) it has

complied and will comply with all applicable provisions of the FSMA with respect to anything done by it in relation to the Notes in, from or otherwise involving the United Kingdom.

8. Represent and agree that: (i) it is able to fend for itself in the transactions contemplated by this Offering Memorandum; (ii) no other representation with respect to the offer or sale of the Notes has been made, other than the information contained in this Offering Memorandum; (iii) the investment decision is solely based on the information contained in the Offering Memorandum; (iv) the Initial Purchasers make no representation or warranty as to the accuracy or completeness of this Offering Memorandum; and (v) it has such knowledge and experience in financial and business matters as to be capable of evaluating the merits and risks of its prospective investment and can afford the complete loss of such investment.

9. Represent and agree that it has received a copy of this Offering Memorandum and acknowledge that it has had access to such financial and other information and has been afforded the opportunity to ask questions of the Issuer and the Guarantors and receive answers thereto, as it deemed necessary in connection with its decision to purchase the Notes.

10. Acknowledge that this Offering Memorandum has been prepared on the basis that all offers of Notes will be made pursuant to an exemption under the Prospectus Directive from the requirement to produce a prospectus for offers of securities.

11. Acknowledge that this Offering Memorandum is for distribution only to persons who (i) have professional experience in matters relating to investments falling within Article 19(5) of the FSMA (Financial Promotion) Order 2005 (as amended, the "Financial Promotion Order"), (ii) are persons falling within Article 49(2)(a) through (d) ("high net worth companies, unincorporated associations, etc.") of the Financial Promotion Order or (iii) are persons to whom an invitation or inducement to engage in investment activity (within the meaning of section 21 of the FSMA) in connection with the issue or sale of any notes may otherwise lawfully be communicated or caused to be communicated (all such persons together being referred to as "relevant persons"). This Offering Memorandum is directed only at relevant persons and must not be acted on or relied on by persons who are not relevant persons. Any investment or investment activity to which this Offering Memorandum relates is available only to relevant persons and will be engaged in only with relevant persons.

12. Acknowledge that the Issuer, the Guarantors, the Initial Purchasers and others will rely upon the truth and accuracy of the foregoing acknowledgments, representations, warranties and agreements and agree that, if any of the acknowledgments, representations, warranties and agreements deemed to have been made by its purchase of the Notes is no longer accurate, it shall promptly notify the Issuer and the Initial Purchasers. If it is acquiring any Notes as a fiduciary or agent of one or more investor accounts, it represents that it has sole investment discretion with respect to each such investor account and that it has full power to make the foregoing acknowledgments, representations and agreements on behalf of each such investor account.

13. Represent that either (i) no portion of the assets used by it or any subsequent transferee to acquire and hold the Notes, or any interest therein, constitutes assets of any Plan or (ii) the purchase, holding and subsequent disposition of the Notes by it or any subsequent transferee will not constitute or result in a non-exempt prohibited transaction under Section 406 of ERISA or Section 4975 of the Code or violate any applicable Similar Law.

14. Represent, if it is purchasing or holding the Notes on behalf of an ERISA Plan, that it (i) is an independent fiduciary to the ERISA Plan and is responsible for exercising independent judgment in evaluating the decision to purchase the Notes on behalf of the ERISA Plan, (ii) is a bank, insurance carrier, investment adviser or broker-dealer described in 29 CFR § 2510.3–21(c)(1)(A), (B), (C) or (D) or holds or has under management total assets of at least $50 million, (iii) is capable of evaluating investment risks independently, both in general and with regard to the purchase and holding of the Notes and (iv) understands and has been fairly informed of the financial interests of the Issuer, Guarantors and Initial Purchasers in connection with the purchase and holding of the Notes.

For further discussion of the requirements (including the presentation of transfer certificates) under the Indenture to effect exchanges or transfer of interests in the Global Notes, see "*Book Entry, Delivery and Form*".

LEGAL MATTERS

The validity of the Notes and the Guarantees offered by this Offering Memorandum and certain legal matters will be passed upon for the Issuer and the Guarantors by Cravath, Swaine & Moore LLP, U.S. counsel for the Issuer and the Guarantors. Certain English law matters will be passed upon for the Issuer and the Guarantors by Linklaters LLP. Certain Dutch legal matters will be passed upon for the Issuer and the Guarantors by Stibbe N.V. Certain U.S. legal matters in connection with the Notes will be passed upon for the Initial Purchasers by Davis Polk & Wardwell London LLP, U.S. counsel for the Initial Purchasers.

INDEPENDENT AUDITORS

Effective March 23, 2015, KPMG UK are our independent public auditors, with an address of 15 Canada Square, London E14 5GL, United Kingdom, as stated in their reports appearing herein. PricewaterhouseCoopers LLP ("PwC") were previously our independent auditors. The reports of KPMG UK with respect to the audited consolidated financial statements of BAT as of December 31, 2016 and 2015 and for each of the years in the two-year period ended December 31, 2016, and with respect to the unaudited condensed consolidated financial statements as of June 30, 2017 and for the six months ended June 30, 2017, are in accordance with guidance issued by The Institute of Chartered Accountants in England and Wales. The report of PwC with respect to the audited consolidated financial statements of BAT as of December 31, 2014 and for the year ended December 31, 2014 are in accordance with guidance issued by The Institute of Chartered Accountants in England and Wales. The PwC report states that: "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". Each KPMG UK report with respect to the audited consolidated financial statements states that: "This report is made solely to the Company's members as a body and is subject to important explanations and disclaimers regarding our responsibilities, published on our website at www.kpmg.com/uk/auditscopeukco2014a, which are incorporated into this report as if set out in full and should be read to provide an understanding of the purpose of this report, the work we have undertaken and the basis of our opinions." The KPMG UK report with respect to the unaudited condensed consolidated financial statements states that: "This report is made solely to the company in accordance with the terms of our engagement to assist the company in meeting the requirements of the DTR of the UK FCA. Our review has been undertaken so that we might state to the company those matters we are required to state to it in this report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company for our review work, for this report, or for the conclusions we have reached." Investors in the Notes should understand these statements are intended to disclaim any liability to parties (such as the purchasers of the Notes) other than BAT and its members, with respect to these reports. In the context of the offering of the Notes, KPMG UK and PwC have reconfirmed to us that they do not intend their duty of care to extend to any party other than those to whom their reports were originally addressed (i.e. BAT and its members).

The SEC would not permit such limiting language to be included in a registration statement or a prospectus used in connection with an offering of securities registered under the Securities Act, or in a report filed under the Exchange Act. If a U.S. court (or any other court) were to give effect to such limiting language, the recourse that investors in the Notes may have against KPMG UK or PwC, as applicable, based on their applicable reports or the consolidated financial statements to which they relate could be limited.

ADDITIONAL INFORMATION

Listing

An application has been made for the Notes to be listed on the Official List of the UK Listing Authority and for admission of the Notes to trading on the PSM. The estimated fees and expenses related to the admission of the Notes to trading will be approximately £11,450.

Clearing Reference Numbers

The Notes have been accepted for clearance through DTC's book-entry settlement system and through Euroclear and Clearstream, Luxembourg. The CUSIP and ISIN numbers for the Notes are as follows:

Rule 144A	CUSIP Numbers	ISIN Numbers
2020 Fixed Rate Notes	05526DAQ8	US05526DAQ88
2022 Fixed Rate Notes	05526DAU9	US05226DAU90
2024 Fixed Rate Notes	05526DAY1	US05526DAY13
2027 Fixed Rate Notes	05526DBA2	US05526DBA28
2037 Fixed Rate Notes	05526DBC8	US05526DBC83
2047 Fixed Rate Notes	05526DBE4	US05526DBE40
2020 Floating Rate Notes	05526DAS4	US05526DAS45
2022 Floating Rate Notes	05526DAW5	US05526DAW56

Regulation S	CUSIP Numbers	ISIN Numbers
2020 Fixed Rate Notes	U05526AE5	USU05526AE50
2022 Fixed Rate Notes	U05526AG0	USU05526AG09
2024 Fixed Rate Notes	U05526AJ4	USU05526AJ48
2027 Fixed Rate Notes	U05526AK1	USU05526AK11
2037 Fixed Rate Notes	U05526AL9	USU05526AL93
2047 Fixed Rate Notes	U05526AM7	USU05526AM76
2020 Floating Rate Notes	U05526AF2	USU05526AF26
2022 Floating Rate Notes	U05526AH8	USU05526AH81

Interests of Natural and Legal Persons Involved in the Issuance of the Notes

Save as discussed in the section of this Offering Memorandum entitled "*Plan of Distribution*", so far as the Issuer and each of the Guarantors are aware, no person involved in the offer of the Notes has an interest material to such offer.

Incorporation of the Issuer

BATCAP was incorporated with limited liability under the laws of the State of Delaware, United States of America on April 6, 1981. BATCAP is domiciled in the State of Delaware and is a wholly owned indirect subsidiary of BAT. BATCAP does not have any subsidiary entities. The registered office of BATCAP is located at 103 Foulk Road, Suite 120, Wilmington, Delaware 19803, United States of America, Tel: +1 (302) 691 6323.

The following is a list of the directors of BATCAP:

Name	Function
L.B. Cotton	Director
J.J. Koach	Director
N.A. Wadey	Director
M.J. Walter	Director

None of the directors listed above performs activities outside BATCAP or the BAT Group which are significant with respect to the BAT Group. Except for N.A. Wadey, whose business address is Globe House, 4 Temple Place, London WC2R 2PG, the business address of the directors of BATCAP is 103 Foulk Road, Suite 120, Wilmington, Delaware 19803, United States of America. The duties owed by the directors do not give rise to any potential conflicts of interests with such directors' private interests and other duties.

Incorporation of the Guarantors

Parent Guarantor

BAT was incorporated on July 23, 1997 under the laws of England and Wales with registration no. 03407696 as a public limited liability company. BAT was registered as an external company in the Republic of South Africa on October 13, 2008 with the registration number 2008/023963/10. The principal place of

business and registered office of the Parent Guarantor is located at Globe House, 4 Temple Place, London WC2R 2PG, United Kingdom, tel: +44 (0)20 7845 1000. The Parent Guarantor's representative office in South Africa is located at 34 Alexander Street, Stellenbosch 7600, South Africa (P.O. Box 631, Cape Town, 8000, South Africa). The Parent Guarantor is domiciled in the United Kingdom.

BATIF

BATIF was incorporated as a private limited company under the laws of England and Wales on July 10, 1972 with registration no. 1060930 and was re-registered as a public limited liability company on September 8, 1981. BATIF is domiciled in the United Kingdom and is a wholly owned subsidiary of BAT. BATIF has two subsidiaries, B.A.T Finance B.V. and BATIF Dollar Limited. The registered office of BATIF is located at Globe House, 4 Temple Place, London WC2R 2PG, United Kingdom, Tel: +44 (0)20 7845 1000.

The following is a list of the directors of BATIF:

Name	Function
R.R. Bakker	Director
R.J. Casey	Director
S.G. Dale	Director
J.B. Stevens	Director
N.A. Wadey	Director

None of the directors listed above performs activities outside BATIF or the BAT Group which are significant with respect to the BAT Group. The business address of the directors of BATIF is Globe House, 4 Temple Place, London WC2R 2PG, United Kingdom. The duties owed by the directors do not give rise to any potential conflicts of interests with such directors' private interests and other duties.

BATHTN

British American Tobacco Holdings (The Netherlands) B.V. was incorporated as a private company with limited liability (*besloten vennootschap met beperkte aansprakelijkheid*) under the laws of The Netherlands on February 24, 1992. It has its statutory seat (*statutaire zetel*) in Amstelveen, The Netherlands and is registered with the Trade Register (*Handelsregister*) of the Chamber of Commerce under registration no. 33236251. BATHTN is a wholly owned indirect subsidiary of BAT and is the investment holding company for the Dutch tobacco interests and a number of foreign tobacco interests of the BAT Group. The principal place of business and registered office of BATHTN are located at Handelsweg 53A, 1181 ZA Amstelveen, The Netherlands, tel: +31 (0)20 540 6911. BATHTN is domiciled in The Netherlands.

The following is a list of the directors of BATHTN:

Name	Function
J.E.P. Bollen	Director
D.P.I. Booth	Director
H.M.J. Lina	Director
J.C. Nooij	Director
N.A. Wadey	Director
M. Wiechers	Director

None of the directors listed above performs activities outside BATHTN or the BAT Group which are significant with respect to the BAT Group. Except for D.P.I. Booth and N.A. Wadey, whose business address is Globe House, 4 Temple Place, London WC2R 2PG, United Kingdom, the business address of the directors of BATHTN is Handelsweg 53A, 1181 ZA Amstelveen, The Netherlands. The duties owed by the directors do not give rise to any potential conflicts of interests with such directors' private interests and other duties.

BATNF

B.A.T. Netherlands Finance B.V. was incorporated as a private company with limited liability (*besloten vennootschap met beperkte aansprakelijkheid*) under the laws of The Netherlands on April 23, 2014. It has its statutory seat (*statutaire zetel*) in Amstelveen, The Netherlands and is registered with the Trade Register (*Handelsregister*) of the Chamber of Commerce under registration no. 60533536. BATNF is a wholly owned indirect subsidiary of BAT and its principal function is to operate as a financing company for the BAT Group. The principal place of business and registered office of BATNF are located at Handelsweg 53A, 1181 ZA Amstelveen, The Netherlands, tel: +31 (0)20 540 6911. BATNF is domiciled in The Netherlands.

The following is a list of the directors of BATNF:

Name	Function
J.E.P. Bollen	Director
D.P.I. Booth	Director
H.M.J. Lina	Director
J.C. Nooij	Director
N.A. Wadey	Director
M. Wiechers	Director

None of the directors listed above performs activities outside BATNF or the BAT Group which are significant with respect to the BAT Group. Except for D.P.I. Booth and N.A. Wadey, whose business address is Globe House, 4 Temple Place, London WC2R 2PG, United Kingdom, the business address of the directors of BATNF is Handelsweg 53A, 1181 ZA Amstelveen, The Netherlands. The duties owed by the directors do not give rise to any potential conflicts of interests with such directors' private interests and other duties.

RAI

Reynolds American Inc. was incorporated in the State of North Carolina on January 2, 2004. RAI's registered office is located at 401 North Main Street, Winston- Salem, North Carolina 27101, and its telephone number is +1 (336) 741-2000.

The following is a list of the directors of RAI:

Name	Function
Debra A. Crew	Director
McDara P. Folan, III	Director
Martin L. Holton III	Director
Tony Hayward	Director

None of the directors listed above performs activities outside RAI or the BAT Group which are significant with respect to the BAT Group. The business address of the directors of RAI is 401 South 4th Street, Suite 1010, Louisville, KY 40202. The duties owed by the directors do not give rise to any potential conflicts of interests with such directors' private interests and other duties.

Corporate Authority

We have obtained all necessary consents, approvals and authorizations in connection with the issuance and performance of the Notes. Resolutions of BATCAP's board of directors, dated July 20, 2017, authorized the issuance of the Notes. The Guarantees of the Notes have been authorized by resolutions of BAT's board of directors, dated July 25, 2017, the resolutions of BATIF's board of directors, dated July 20, 2017, the resolutions of BATHTN's board of directors, dated July 31, 2017, the resolutions of BATNF's board of directors, dated July 31, 2017 and the resolutions of RAI's board of directors, dated August 2, 2017.

Persons Responsible

The Issuer and each of the Guarantors accept responsibility for the information contained in this Offering Memorandum. To the best of the knowledge and belief of the Issuer and each of the Guarantors (having taken all reasonable care to ensure that such is the case), the information contained in this Offering Memorandum is in accordance with the facts and does not omit anything likely to affect the import of such information.

Absence of Significant Changes

There has been no material adverse change in the prospects of the Issuer or the Guarantors since December 31, 2016. Save as discussed in under the heading "*The Merger*" and under the heading "*Recent Developments*" in "*Trading Update and Other Recent Developments*", there has been no significant change in the financial or trading position of BAT or RAI since June 30, 2017 nor BATHTN, BATNF or BATIF since December 31, 2016.

Absence of Litigation

Except as disclosed under "*Business of BAT*" and "*Business of RAI*" in this Offering Memorandum, there are no governmental, legal or arbitration proceedings which are pending or threatened of which the Issuer, the Guarantors and/or any of their subsidiaries are aware) which may have or have had in the recent past, significant effects on the financial position or profitability of the Issuer, the Guarantors or any of their subsidiaries taken as a whole. Since many of the pending cases seek unspecified damages, it is not possible to quantify the total amount being claimed.

Third-Party Information

The information contained in this Offering Memorandum which has been sourced from a third party has been accurately reproduced and, as far as the Guarantors and the Issuer are aware and able to ascertain from information published by that third party, no facts have been omitted which could render the reproduced information inaccurate or misleading.

Yield

The yield of the:

2020 Fixed Rate Notes is 2.297% on an annual basis

2022 Fixed Rate Notes is 2.764% on an annual basis

2024 Fixed Rate Notes is 3.222% on an annual basis

2027 Fixed Rate Notes is 3.557% on an annual basis

2037 Fixed Rate Notes is 4.390% on an annual basis

2047 Fixed Rate Notes is 4.540% on an annual basis

The yield in each case is calculated as of August 8, 2017, on the basis of the issue price set out on the cover of this Offering Memorandum. It is not an indication of future yield.

Periodic Reporting under the Exchange Act

We are currently subject to the periodic reporting and other information requirements of the Exchange Act.

Documents Available for Inspection

For so long as any Notes remain outstanding, copies of the documents listed in (a) and (c) below will be available at the offices of the Trustee and copies of the documents listed in (b), (d) and (e) below will be available for inspection only at the offices of the Trustee during usual business hours on any weekday (Saturdays, Sundays and public holidays excepted). For so long as any Notes are listed on the London Stock Exchange, copies of the documents listed in (a), (c), (g) and (h) below will be available at the offices of the London paying agent and copies of the documents listed in (b), (d) and (e) below will be available for inspection only at the offices of the London paying agent during usual business hours on any weekday (Saturdays, Sundays and public holidays excepted).

(a) this Offering Memorandum;

(b) the articles of association of each of the Guarantors and the Issuer;

(c) the annual reports and financial information of the Parent Guarantor and BATCAP including the audited consolidated financial information for the periods ended December 31, 2016 and 2015;

(d) the interim management statement of the Parent Guarantor for the six months ended June 30, 2017;

(e) the Indenture;

(f) the Registration Rights Agreement;

(g) the consent letter of KPMG LLP referred to below; and

(h) the report of KPMG LLP on the BAT Unaudited Pro Forma Condensed Combined Financial Information set out in "*BAT Unaudited Pro Forma Condensed Combined Financial Information*".

Consents

KPMG LLP has given, and has not withdrawn, its written consent to the inclusion in this Offering Memorandum of its report in the "*BAT Unaudited Pro Forma Condensed Combined Financial Information*" section of this Offering Memorandum, in the form and context in which it appears and has authorized the contents of that report.

INDEX TO FINANCIAL STATEMENTS

The financial statements contained herein (which appear on pages with number preceded by "F-" use different defined terms than those used elsewhere in this Offering Memorandum. For the purposes of this section only, unless otherwise specified, on any given such page, the term "company", "Company", "parent Company", or "Parent Company" means the company identified at the top right-hand corner of that page and "British American Tobacco p.l.c.", "group", or "Group" means such identified company together with its consolidated subsidiaries.

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The above mentioned financial statements have been extracted without material adjustments from various annual, quarterly and half-year reports and financial statements of British American Tobacco p.l.c., Reynolds American Inc. and B.A.T Capital Corporation (see "Presentation of Financial Information and Other Data") and may contain cross-references to other parts of such annual, quarterly and half-year reports and financial statements or other sources. Such cross-referenced material is not part of, and is not incorporated by reference into, this Offering Memorandum and should be disregarded for the purpose of this Offering Memorandum as it is either not relevant for prospective investors in the Notes or is covered elsewhere herein.

INDEPENDENT REVIEW REPORT TO BRITISH AMERICAN TOBACCO p.l.c.

We have been engaged by the company to review the condensed set of financial statements in the half-yearly financial report for the six months ended 30 June 2017 which comprises 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 and the related explanatory notes.

Based on our review, nothing has come to our attention that causes us to believe that the condensed set of financial statements in the half-yearly financial report for the six months ended 30 June 2017 is not prepared, in all material respects, in accordance with IAS 34 *Interim Financial Reporting* as adopted by the EU and the Disclosure Guidance and Transparency Rules ("the DTR") of the UK's Financial Conduct Authority ("the UK FCA").

Scope of review

We conducted our review in accordance with International Standard on Review Engagements (UK and Ireland) 2410 *Review of Interim Financial Information Performed by the Independent Auditor of the Entity* issued by the Auditing Practices Board for use in the UK. A review of interim financial information consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. We read the other information contained in the half-yearly financial report and consider whether it contains any apparent misstatements or material inconsistencies with the information in the condensed set of financial statements.

A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing (UK) and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Directors' responsibilities

The half-yearly financial report is the responsibility of, and has been approved by, the directors. The directors are responsible for preparing the half-yearly financial report in accordance with the DTR of the UK FCA.

As disclosed in Accounting Policies and Basis of Preparation the annual financial statements of the group are prepared in accordance with International Financial Reporting Standards as adopted by the EU. The directors are responsible for preparing the condensed set of financial statements included in the half-yearly financial report in accordance with IAS 34 as adopted by the EU.

Our responsibility

Our responsibility is to express to the company a conclusion on the condensed set of financial statements in the half-yearly financial report based on our review.

The purpose of our review work and to whom we owe our responsibilities

This report is made solely to the company in accordance with the terms of our engagement to assist the company in meeting the requirements of the DTR of the UK FCA. Our review has been undertaken so that we might state to the company those matters we are required to state to it in this report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company for our review work, for this report, or for the conclusions we have reached.

Mark Baillache

for and on behalf of KPMG LLP
Chartered Accountants
15 Canada Square, London E14 5GL
26 July 2017

GROUP INCOME STATEMENT — UNAUDITED

	6 months to		Year to
	30.6.17	**30.6.16**	**31.12.16**
	£m	**£m**	**£m**
Gross turnover (including duty, excise and other taxes of £17,377 million (30.6.16: £14,364 million; 31.12.16: £32,136 million))	**25,094**	21,033	46,887
Revenue	**7,717**	**6,669**	**14,751**
Raw materials and consumables used	**(1,881)**	(1,630)	(3,777)
Changes in inventories of finished goods and work in progress	**(59)**	8	44
Employee benefit costs	**(1,144)**	(1,034)	(2,274)
Depreciation, amortisation and impairment costs	**(346)**	(253)	(607)
Other operating income	**55**	49	176
Other operating expenses	**(1,768)**	(1,596)	(3,658)
Profit from operations	**2,574**	**2,213**	**4,655**
Analysed as:			
– adjusted profit from operations	**2,841**	2,452	5,480
– restructuring and integration costs	**(133)**	(161)	(603)
– amortisation and impairment of trademarks and similar intangibles	**(134)**	(58)	(149)
– Fox River	**—**	(20)	(20)
– South Korea sales tax	**—**	—	(53)
	2,574	2,213	4,655
Net finance costs	**(325)**	(233)	(637)
Finance income	**56**	27	44
Finance costs	**(381)**	(260)	(681)
Share of post-tax results of associates and joint ventures	**778**	1,446	2,227
Analysed as:			
– adjusted share of post-tax results of associates and joint ventures	**756**	605	1,327
– issue of shares and change in shareholding	**34**	13	11
– gain on disposal of assets	**—**	890	941
– other	**(12)**	(62)	(52)
	778	1,446	2,227
Profit before taxation	**3,027**	**3,426**	**6,245**
Taxation on ordinary activities	**(680)**	(685)	(1,406)
Profit for the period	**2,347**	**2,741**	**4,839**
Attributable to:			
Owners of the parent	**2,261**	2,671	4,648
Non-controlling interests	**86**	70	191
	2,347	2,741	4,839
Earnings per share			
Basic	**121.8p**	143.8p	250.2p
Diluted	**121.4p**	143.4p	249.2p
Adjusted diluted	**134.4p**	111.1p	247.5p

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

The accompanying notes form an integral part of this condensed consolidated financial information.

GROUP STATEMENT OF COMPREHENSIVE INCOME — UNAUDITED

	6 months to		Year to
	30.6.17	30.6.16	31.12.16
	£m	£m	£m
Profit for the period	**2,347**	2,741	4,839
Other comprehensive income			
Items that may be reclassified subsequently to profit or loss:	**(536)**	995	1,760
Differences on exchange			
– subsidiaries	**(216)**	1,124	1,270
– associates	**(393)**	764	1,425
Cash flow hedges			
– net fair value (losses)/gains	**(166)**	(226)	29
– reclassified and reported in profit for the period	**13**	106	38
– reclassified and reported in net assets	**(13)**	(22)	(12)
Available-for-sale investments of associates			
– net fair value gains/(losses) in respect of associates, net of tax	**5**	(7)	(10)
Net investment hedges			
– net fair value gains/(losses)	**237**	(644)	(837)
– differences on exchange on borrowings	**(56)**	(100)	(124)
Tax on items that may be reclassified	**53**	—	(19)
Items that will not be reclassified subsequently to profit or loss:	**115**	(427)	(173)
Retirement benefit schemes			
– net actuarial gains/(losses) in respect of subsidiaries	**119**	(459)	(228)
– surplus recognition and minimum funding obligations in respect of subsidiaries	**(1)**	(1)	(1)
– actuarial gains/(losses) in respect of associates, net of tax	**36**	(45)	20
Tax on items that will not be reclassified	**(39)**	78	36
Total other comprehensive income for the period, net of tax	**(421)**	568	1,587
Total comprehensive income for the period, net of tax	**1,926**	3,309	6,426
Attributable to:			
Owners of the parent	**1,853**	3,209	6,180
Non-controlling interests	**73**	100	246
	1,926	3,309	6,426

The accompanying notes form an integral part of this condensed consolidated financial information.

GROUP STATEMENT OF CHANGES IN EQUITY — unaudited

At 30 June 2017

	Attributable to owners of the parent						
	Share capital	**Share premium, capital redemption and merger reserves**	**Other reserves**	**Retained earnings**	**Total attributable to owners of parent**	**Non-controlling interests**	**Total equity**
	£m	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
Balance at 1 January 2017	**507**	**3,931**	**413**	**3,331**	**8,182**	**224**	**8,406**
Total comprehensive income for the period	—	—	(523)	2,376	1,853	73	1,926
Profit for the period	—	—	—	2,261	2,261	86	2,347
Other comprehensive income for the period	—	—	(523)	115	(408)	(13)	(421)
Employee share options							
– value of employee services	—	—	—	36	36	—	36
– proceeds from shares issued	—	2	—	—	2	—	2
Dividends and other appropriations							
– ordinary shares	—	—	—	(2,181)	(2,181)	—	(2,181)
– to non-controlling interests	—	—	—	—	—	(105)	(105)
Purchase of own shares							
– held in employee share ownership trusts	—	—	—	(215)	(215)	—	(215)
– deferred tax on employee share schemes	—	—	—	42	42	—	42
Other movements	—	—	(1)	(1)	(2)	—	(2)
Balance at 30 June 2017	**507**	**3,933**	**(111)**	**3,388**	**7,717**	**192**	**7,909**

At 30 June 2016

	Attributable to owners of the parent						
	Share capital	**Share premium, capital redemption and merger reserves**	**Other reserves**	**Retained earnings**	**Total attributable to owners of parent**	**Non-controlling interests**	**Total equity**
	£m	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
Balance at 1 January 2016	507	3,927	(1,294)	1,754	4,894	138	5,032
Total comprehensive income for the period	—	—	965	2,244	3,209	100	3,309
Profit for the period	—	—	—	2,671	2,671	70	2,741
Other comprehensive income for the period	—	—	965	(427)	538	30	568
Employee share options							
– value of employee services	—	—	—	27	27	—	27
– proceeds from shares issued	—	2	—	—	2	—	2
Dividends and other appropriations							
– ordinary shares	—	—	—	(1,950)	(1,950)	—	(1,950)
– to non-controlling interests	—	—	—	—	—	(92)	(92)
Purchase of own shares							
– held in employee share ownership trusts	—	—	—	(65)	(65)	—	(65)
Non-controlling interests — acquisitions	—	—	—	4	4	(4)	—
Other movements	—	—	—	(11)	(11)	—	(11)
Balance at 30 June 2016	507	3,929	(329)	2,003	6,110	142	6,252

GROUP STATEMENT OF CHANGES IN EQUITY — unaudited (Continued)

At 31 December 2016

	Attributable to owners of the parent						
	Share capital	Share premium, capital redemption and merger reserves	Other reserves	Retained earnings	Total attributable to owners of parent	Non-controlling interests	Total equity
	£m	£m	£m	£m	£m	£m	£m
Balance at 1 January 2016	507	3,927	(1,294)	1,754	4,894	138	5,032
Total comprehensive income for the year	—	—	1,707	4,473	6,180	246	6,426
Profit for the year	—	—	—	4,648	4,648	191	4,839
Other comprehensive income for the year	—	—	1,707	(175)	1,532	55	1,587
Employee share options							
– value of employee services	—	—	—	71	71	—	71
– proceeds from shares issued	—	4	—	—	4	—	4
Dividends and other appropriations							
– ordinary shares	—	—	—	(2,910)	(2,910)	—	(2,910)
– to non-controlling interests	—	—	—	—	—	(156)	(156)
Purchase of own shares							
– held in employee share ownership trusts	—	—	—	(64)	(64)	—	(64)
Non-controlling interests — acquisitions	—	—	—	4	4	(4)	—
Other movements	—	—	—	3	3	—	3
Balance at 31 December 2016	507	3,931	413	3,331	8,182	224	8,406

The accompanying notes form an integral part of this condensed consolidated financial information.

GROUP BALANCE SHEET — unaudited

	30.6.17	30.6.16	31.12.16
	£m	£m	£m
Assets			
Non-current assets			
Intangible assets	**12,177**	11,780	12,117
Property, plant and equipment	**3,636**	3,274	3,661
Investments in associates and joint ventures	**9,438**	8,726	9,507
Retirement benefit assets	**615**	273	455
Deferred tax assets	**468**	383	436
Trade and other receivables	**758**	409	599
Available-for-sale investments	**44**	42	43
Derivative financial instruments	**576**	663	596
Total non-current assets	**27,712**	25,550	27,414
Current assets			
Inventories	**5,177**	4,725	5,793
Income tax receivable	**71**	81	69
Trade and other receivables	**3,833**	3,390	3,884
Available-for-sale investments	**26**	61	15
Derivative financial instruments	**312**	532	375
Cash and cash equivalents	**2,019**	1,882	2,204
	11,438	10,671	12,340
Assets classified as held-for-sale	**36**	18	19
Total current assets	**11,474**	10,689	12,359
Total assets	**39,186**	36,239	39,773

The accompanying notes form an integral part of this condensed consolidated financial information.

GROUP BALANCE SHEET — unaudited (continued)

	30.6.17	30.6.16	31.12.16
	£m	£m	£m
Equity			
Capital and reserves			
Share capital	**507**	507	507
Share premium, capital redemption and merger reserves	**3,933**	3,929	3,931
Other reserves	**(111)**	(349)	413
Retained earnings	**3,388**	2,023	3,331
Owners of the parent	**7,717**	6,110	8,182
after deducting – cost of treasury shares	**(5,215)**	(5,069)	(5,053)
Non-controlling interests	**192**	142	224
Total equity	**7,909**	6,252	8,406
Liabilities			
Non-current liabilities			
Borrowings	**15,085**	14,888	16,488
Retirement benefit liabilities	**827**	925	826
Deferred tax liabilities	**659**	657	652
Other provisions for liabilities and charges	**395**	312	386
Trade and other payables	**1,036**	1,020	1,040
Derivative financial instruments	**79**	398	119
Total non-current liabilities	**18,081**	18,200	19,511
Current liabilities			
Borrowings	**5,822**	5,343	3,007
Income tax payable	**622**	396	558
Other provisions for liabilities and charges	**330**	306	407
Trade and other payables	**5,948**	5,080	7,335
Derivative financial instruments	**474**	662	549
Total current liabilities	**13,196**	11,787	11,856
Total equity and liabilities	**39,186**	36,239	39,773

The accompanying notes form an integral part of this condensed consolidated financial information.

GROUP CASH FLOW STATEMENT — unaudited

	6 months to 30.6.17 £m	6 months to 30.6.16 £m	Year to 31.12.16 £m
Cash flows from operating activities			
Cash generated from operations (note 4(c))	**1,788**	1,350	4,893
Dividends received from associates	**465**	324	962
Tax paid	**(547)**	(620)	(1,245)
Net cash generated from operating activities	**1,706**	1,054	4,610
Cash flows from investing activities			
Interest received	**34**	26	62
Purchases of property, plant and equipment	**(198)**	(120)	(586)
Proceeds on disposal of property, plant and equipment	**23**	23	93
Purchases of intangibles	**(99)**	(29)	(88)
Purchases of investments	**(90)**	(75)	(109)
Proceeds on disposals of investments	**85**	8	22
Investment in associates and acquisition of subsidiaries	**(52)**	(53)	(57)
Proceeds from associates' share buy-backs	**—**	—	23
Net cash used in investing activities	**(297)**	(220)	(640)
Cash flows from financing activities			
Interest paid	**(379)**	(316)	(641)
Proceeds from increases in and new borrowings	**3,839**	2,327	3,476
(Outflows)/Inflows relating to derivative financial instruments	**(108)**	133	(26)
Purchases of own shares held in employee share ownership trusts	**(215)**	(65)	(64)
Reductions in and repayments of borrowings	**(2,365)**	(1,013)	(3,840)
Dividends paid to owners of the parent	**(2,179)**	(1,950)	(2,910)
Purchases of non-controlling interests	**—**	(70)	(70)
Dividends paid to non-controlling interests	**(106)**	(94)	(147)
Other	**2**	(3)	(7)
Net cash used in financing activities	**(1,511)**	(1,051)	(4,229)
Net cash flows used in operating, investing and financing activities	**(102)**	(217)	(259)
Differences on exchange	**(139)**	(53)	180
Decrease in net cash and cash equivalents in the period	**(241)**	(270)	(79)
Net cash and cash equivalents at 1 January	**1,651**	1,730	1,730
Net cash and cash equivalents at period end	**1,410**	1,460	1,651

The accompanying notes form an integral part of this condensed consolidated financial information.

The net cash outflows relating to the Quebec Class Action (see note 10) and adjusting items in note 3, included in the above, are £352 million, (30 June 2016: £238 million, 31 December 2016: £711 million).

1 ACCOUNTING POLICIES AND BASIS OF PREPARATION

The condensed consolidated financial information comprises the unaudited interim financial information for the six months to 30 June 2017 and 30 June 2016, together with the audited results for the year ended 31 December 2016. This condensed consolidated financial information has been prepared in accordance with IAS 34 *Interim Financial Reporting* as adopted by the EU and as issued by the IASB, and the Disclosure Guidance and Transparency Rules issued by the Financial Conduct Authority. The condensed consolidated financial information is unaudited but has been reviewed by the auditor and its review report is set out above.

The condensed consolidated financial information does not constitute statutory accounts within the meaning of the UK Companies Act 2006 and should be read in conjunction with the annual consolidated financial statements for the year ended 31 December 2016, which were prepared in accordance with IFRS. The annual consolidated financial statements for 2016 represent the statutory accounts for that year and have been filed with the Registrar of Companies. The auditor's report on those statements was unmodified and did not contain an emphasis of matter paragraph and did not contain any statement under Section 498 (2) or (3) of the Companies Act 2006.

This condensed consolidated financial information has been prepared under the historical cost convention, except in respect of certain financial instruments, and on a basis consistent with the IFRS accounting policies as set out in the BAT Group's 2016 consolidated financial statements.

The preparation of this condensed consolidated financial information 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 this condensed consolidated financial information. Such estimates and assumptions are based on historical experience and various other factors that are believed to be reasonable in the circumstances and constitute management's best judgement at the date of the condensed consolidated financial information. The key estimates and assumptions were the same as those that applied to the consolidated financial information for the year ended 31 December 2016, apart from updating the assumptions used to determine the carrying value of liabilities for retirement benefit schemes. In the future, actual experience may deviate from these estimates and assumptions, which could affect this condensed consolidated financial information as the original estimates and assumptions are modified, as appropriate, in the period in which the circumstances change.

NON-GAAP MEASURES

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

The principal non-GAAP measures which the Group uses are adjusted revenue, adjusted profit from operations and adjusted diluted earnings per share, which are reconciled to revenue, profit from operations and diluted earnings per share. Adjusting items are significant items in revenue, 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 analysis, or in the notes to the financial information as appropriate. The adjusting items are used to calculate the non-GAAP measures of adjusted revenue, adjusted profit from operations, adjusted net finance costs, adjusted taxation, adjusted share of post-tax results of associates and joint ventures and adjusted diluted earnings per share. The Group also includes organic measures of volume to ensure a full understanding of the underlying performance of the Group, before the impact of acquisitions.

All adjustments to revenue, profit from operations, net finance costs, taxation, share of post-tax results of associates and joint ventures and diluted earnings per share are explained in this announcement. See note 3 and note 8.

The Management Board, as the chief operating decision maker, reviews current and prior year segmental adjusted revenue, adjusted profit from operations of subsidiaries and joint operations, and adjusted post-tax results of associates and joint ventures, at constant rates of exchange. This allows comparison of the Group's results, had they been translated at the previous year's average rates of exchange. The Group does not adjust for the normal transactional gains and losses in operations that are generated by exchange movements. However, for clarity and where useful to the users of the financial information, the Group also gives a figure for growth in adjusted operating profit excluding both transactional and translational foreign exchange movements. Although

the Group does not believe that these measures are a substitute for IFRS measures, the Group does believe that such results excluding the impact of currency fluctuations year-on-year provide additional useful information to investors regarding the operating performance on a local currency basis. As an additional measure to indicate the impact of the exchange rate movements on the Group results, the principal measure of adjusted diluted earnings per share is also shown at constant translation rates of exchange. See note 2.

The Group prepares an alternative cash flow, which includes a measure of 'free cash flow', to illustrate the cash flows before transactions relating to borrowings. A net debt summary is also provided in note 4(b). The Group publishes gross turnover as an additional disclosure to indicate the impact of duty, excise and other taxes.

The Management Board believes that free cash flow, which is used internally, is useful to the users of the financial statements in helping them understand the underlying business performance and can provide insight into the cash flow available to, among other things, reduce debt and pay dividends. Free cash flow has limitations as an analytical tool. It is not a presentation made in accordance with IFRS and should not be considered as an alternative to net cash generated from operating activities determined in accordance with IFRS. Free cash flow is not necessarily comparable to similarly titled measures used by other companies. As a result, readers should not consider this measure in isolation from, or as a substitute analysis for, the Group's results of operations or cash flows as determined in accordance with IFRS.

The Group uses net debt to assess its financial capacity. The Management Board believes that this additional measure, which is used internally, is useful to the users of the financial statements in helping them to see how business financing has changed over the year. Net debt has limitations as an analytical tool. It is not a presentation made in accordance with IFRS and should not be considered as an alternative to borrowings or total liabilities determined in accordance with IFRS. Net debt is not necessarily comparable to similarly titled measures used by other companies. As a result, you should not consider this measure in isolation from, or as a substitute analysis for, the Group's measures of financial position or liquidity as determined in accordance with IFRS.

Due to the secondary listing of the ordinary shares of British American Tobacco p.l.c. on the main board of the JSE Limited ("JSE") in South Africa, the Group is required to present headline earnings per share and diluted headline earnings per share, as alternative measures of earnings per share, calculated in accordance with Circular 2/2015 'Headline Earnings' issued by the South African Institute of Chartered Accountants. These are shown in note 8.

2 ANALYSIS OF VOLUME, REVENUE, PROFIT FROM OPERATIONS AND DILUTED EARNINGS PER SHARE BY SEGMENT

	30 June 2017							30 June 2016		
	Reported					**Impact of Acqs**	**Organic[2]**	**Reported**		
	Bn					**Bn**	**Bn**	**Bn**		
Volume										
Asia-Pacific	**95**					**—**	**95**			
Americas	**53**					**—**	**53**			
Western Europe	**58**					**(1)**	**57**			
EEMEA	**108**					**—**	**108**			
Total Region	**314**					**(1)**	**313**			
Revenue	**Reported**	**Adj Items**	**Adjusted**	**Exchange**	**Adjusted at CC[1]**	**Impact of Acqs**	**Adj Organic[2] at CC[1]**	**Reported**	**Adj Items**	**Adjusted**
	£m	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
Asia-Pacific	**2,191**	**—**	**2,191**	**(262)**	**1,929**	**—**	**1,929**	1,987	—	1,987
Americas	**1,545**	**—**	**1,545**	**(164)**	**1,381**	**—**	**1,381**	1,297	—	1,297
Western Europe	**2,030**	**(69)**	**1,961**	**(187)**	**1,774**	**(25)**	**1,749**	1,729	—	1,729
EEMEA	**1,951**	**—**	**1,951**	**(197)**	**1,754**	**—**	**1,754**	1,656	—	1,656
Total Region	**7,717**	**(69)**	**7,648**	**(810)**	**6,838**	**(25)**	**6,813**	6,669	—	6,669
Profit from Operations										
Asia-Pacific	**828**	**43**	**871**	**(92)**	**779**	**—**	**779**	700	61	761
Americas	**570**	**46**	**616**	**(67)**	**549**	**—**	**549**	484	52	536
Western Europe	**543**	**146**	**689**	**(70)**	**619**	**—**	**619**	516	74	590
EEMEA	**633**	**32**	**665**	**(81)**	**584**	**—**	**584**	533	32	565
Total Region	**2,574**	**267**	**2,841**	**(310)**	**2,531**	**—**	**2,531**	**2,233**	**219**	**2,452**
Fox River[3]	**—**	**—**	**—**	**—**	**—**			(20)	20	—
Profit from operations	**2,574**	**267**	**2,841**	**(310)**	**2,531**			2,213	239	2,452
Net finance (costs)/income	**(325)**	**49**	**(276)**	**23**	**(253)**			(233)	(20)	(253)
Associates and joint ventures	**778**	**(22)**	**756**	**(95)**	**661**			1,446	(841)	605
Profit before tax	**3,027**	**294**	**3,321**	**(382)**	**2,939**			3,426	(622)	2,804
Taxation	**(680)**	**(48)**	**(728)**	**68**	**(660)**			(685)	27	(658)
Non-controlling interests	**(86)**	**(2)**	**(88)**	**7**	**(81)**			(70)	(6)	(76)
Profit attributable to shareholders	**2,261**	**244**	**2,505**	**(307)**	**2,198**			2,671	(601)	2,070
Diluted number of shares (m)	**1,863**		**1,863**		**1,863**			1,863		1,863
Diluted earnings per share (pence)	**121.4p**		**134.4p**		**118.0p**			143.4p		111.1p

Notes:

(1) CC: profit translated at constant rates of exchange. No adjustment is made for the transactional impact of currency movements on cost of sales, as described in note 1.

(2) Organic performance excludes the contribution from brands acquired from Bulgartabac and the acquisition of ViP and Winnington as described in note 7.

(3) The Fox River charges have not been allocated to any segment as they neither relate to current operations nor to the tobacco business. They are not included in the segmental performance as reported to the chief operating decision maker.

3 ADJUSTING ITEMS

(a): ADJUSTING ITEMS INCLUDED IN REVENUE

Adjusting items in revenue relate to certain contract manufacturing agreements associated with the manufacture and sale of goods. The Group will acquire and sell, for a limited period, goods inclusive of excise, increasing revenue over the course of the contract and distorting operating margin. To better reflect the underlying performance of the Group, this uplift in both revenue and cost of sales has been adjusted for, given the temporary nature of the arrangement.

(b): ADJUSTING ITEMS INCLUDED IN PROFIT FROM OPERATIONS

Adjusting items are significant items in profit from operations which individually or, if of a similar type, in aggregate, are relevant to an understanding of the Group's underlying financial performance. See note 1. These items are separately disclosed as memorandum information on the face of the income statement and in the segmental analyses.

(i) Restructuring and integration costs

Restructuring costs reflect the costs incurred as a result of initiatives to improve the effectiveness and the efficiency of the Group as a globally integrated enterprise, including the relevant operating costs of implementing the new operating model. These costs represent additional expenses incurred that are not related to the normal business and day-to-day activities. The new operating model includes revised organisation structures, standardised processes and shared back office services underpinned by a global single instance of SAP. These initiatives also include a review of the Group's manufacturing operations, supply chain, overheads and indirect costs, organisational structure and systems and software used. The costs of these initiatives, together with the costs of integrating acquired businesses into existing operations, including acquisition costs, are included in profit from operations under the following headings:

	6 months to		Year to
	30.6.17	30.6.16	31.12.16
	£m	£m	£m
Employee benefit costs	**50**	72	240
Depreciation and impairment costs	**6**	18	64
Other operating expenses	**77**	71	325
Other operating income	**—**	—	(26)
Total	**133**	161	603

Restructuring and integration costs in the six months to 30 June 2017 include advisor fees and costs incurred related to the acquisition of the remaining shares in Reynolds not already owned by the Group, that completed on 25 July 2017 (see note 7). It also includes the implementation of a new operating model and the cost of packages in respect of permanent headcount reductions and permanent employee benefit reductions in the Group. The costs also cover the factory closure and downsizing activities in Germany.

Restructuring and integration costs in the six months to 30 June 2016 principally relate to the implementation of a new operating model and the cost of packages in respect of permanent headcount reductions and permanent employee benefit reductions in the Group. The costs also cover the factory closure and downsizing activities in Malaysia and Brazil.

For the year ended 31 December 2016, restructuring and integration costs principally included the activities referred to in respect of the six months to 30 June 2016. In addition, the costs also covered restructurings in Japan and Australia, the factory closure in Germany, certain exit costs and asset write-offs related to the change in the approach to the commercialisation of Voke and uncertainties surrounding regulatory changes.

(ii) Amortisation and impairment of trademarks and similar intangibles

The acquisition of trademarks from Bulgartabac Holdings and previous business combinations, including TDR, Bentoel, Tekel and ST, have resulted in the capitalisation of trademarks and similar intangibles that are amortised over their expected useful lives, which do not exceed 20 years. The amortisation charge of £134 million is included in depreciation, amortisation and impairment costs in the profit from operations for the six months to 30 June 2017 (30 June 2016: £58 million). For the year to 31 December 2016, the amortisation charge was £149 million.

(iii) Fox River

In 2011, a Group subsidiary provided £274 million in respect of claims in relation to environmental clean-up costs of the Fox River. On 30 September 2014, a Group subsidiary, NCR, Appvion and Windward Prospects

entered into a Funding Agreement with regard to the costs for the clean-up of Fox River. Based on this Funding Agreement, in the six months to 30 June 2017, £2 million has been paid (30 June 2016: £9 million, 31 December 2016: £17 million).

In January 2017, NCR and Appvion entered into a consent decree with the US Government to resolve how the remaining clean-up will be funded and to resolve further outstanding claims between them, although this consent decree requires approval from the District Court of Wisconsin. Considering these developments, the provision has been reviewed. No adjustment has been proposed, other than as related to the charge above, with the provision standing at £161 million at 30 June 2017.

In July 2016, the High Court ruled in a Group subsidiary's favour that a dividend of €135 million paid by Windward to Sequana in May 2009 was a transaction made with the intention of putting assets beyond the reach of the Group subsidiary and of negatively impacting its interests. On 10 February 2017, further to a hearing in January 2017 to determine the relief due, the Court found in the Group subsidiary's favour, ordering that Sequana must pay an amount up to the full value of the dividend plus interest which equates to around US$185 million, related to past and future clean-up costs. The Court granted all parties leave to appeal, with an appeal hearing expected in late 2017 at the earliest. Due to the uncertain outcome of the case no asset has been recognised in relation to this ruling. In February 2017, Sequana entered into a process in France seeking court protection (the "Sauvegarde").

(iv) South Korea sales tax

In 2016, the Board of Audit and Inspection of Korea ("BAI") concluded its tax assessment in relation to the 2014 year-end tobacco inventory and imposed additional sales tax (excise and VAT) and penalties. This resulted in the recognition of a £53 million charge by a Group subsidiary. Management deems the tax and penalties to be unfounded and has appealed to the tax tribunal against the assessment. Management believes that this appeal will be successful and based upon the Group's expectation that the penalties will be reversed in future, BAT has recognised the tax and penalties charge as adjusting for 2016.

(c): ADJUSTING ITEMS INCLUDED IN NET FINANCING COSTS

Adjusting items are significant items in net financing costs which individually or, if of a similar type, in aggregate, are relevant to an understanding of the Group's underlying financial performance and are discussed in note 13.

(d): ADJUSTING ITEMS INCLUDED IN SHARE OF POST-TAX RESULTS OF ASSOCIATES AND JOINT VENTURES

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 8.

In the six months to 30 June 2017:

The Group's interest in ITC decreased from 29.89% to 29.80% as a result of ITC issuing ordinary shares under the company's Employee Share Option Scheme. The issue of these shares and change in the Group's share of ITC resulted in a gain of £34 million, which is treated as a deemed partial disposal and included in the income statement.

Reynolds has recognised amounts that have been combined in the table of adjusting items in the Group income statement and are shown as "other". This mainly includes restructuring charges of US$33 million, the Group's share of which is £7 million (net of tax) and costs in respect of a number of Engle progeny lawsuits and other tobacco litigation charges that amounted to US$16 million, the Group's share of which is £3 million (net of tax).

In the six months to 30 June 2016:

The Group's interest in ITC decreased from 30.06% to 29.99% as a result of ITC issuing ordinary shares under the company's Employee Share Option Scheme. The issue of these shares and change in the Group's share of ITC resulted in a gain of £13 million, which is treated as a deemed partial disposal and included in the income statement.

Reynolds recognised a gain on the sale of the international rights to Natural American Spirit of US$4,861 million. The Group's share of this net gain amounted to £890 million (net of tax).

Reynolds has also recognised amounts that have been combined in the table of adjusting items in the Group income statement and are shown as "other". This includes restructuring charges of US$28 million, the Group's

share of which is £5 million (net of tax), costs in respect of a number of Engle progeny lawsuits and other tobacco litigation charges that amounted to US$61 million, the Group's share of which is £11 million (net of tax). Also included are financing costs of US$243 million connected with the acquisition of Lorillard Inc. the Group's share of which is £46 million (net of tax).

For the year ended 31 December 2016:

In 2016, the Group's interest in ITC decreased from 30.06% to 29.89% as a result of ITC issuing ordinary shares under the Company's Employee Share Option Scheme. The issue of these shares and change in the Group's share of ITC resulted in a gain of £11 million, which is treated as a deemed partial disposal and included in the income statement.

In 2016, Reynolds recognised a gain in relation to the sale of the international rights to Natural American Spirit to JTI of US$4,861 million. The Group's share of this net gain amounted to £941 million (net of tax).

Reynolds has also recognised amounts that have been combined in the table of adjusting items in the Group income statement and are included within "other". In 2016, this includes income relating to the early termination of the Manufacturing Agreement between BATUS Japan Inc. and R.J. Reynolds Tobacco Company of US$90 million, the Group's share of which is £18 million (net of tax), restructuring charges of US$36 million, the Group's share of which is £7 million (net of tax) and costs in respect of a number of Engle progeny lawsuits and other tobacco litigation charges that amounted to US$86 million, the Group's share of which is £17 million (net of tax).

Additionally, there was income of US$6 million (2015: US$108 million) related to the Non-Participating Manufacturer ("NPM") Adjustment claims of the states no longer challenging the findings of non-diligence entered against them by an Arbitration Panel, the Group's share of which is £2 million (net of tax). Also included in 2016 are transaction costs of US$5 million and financing costs of US$243 million, connected with the acquisition of Lorillard, the Group's share (net of tax) of which is £1 million and £47 million, respectively.

(e): ADJUSTING ITEMS INCLUDED IN TAXATION

IFRS requires entities to provide deferred taxation on the undistributed earnings of associates and joint-ventures. As explained in note 15, the Group's share of gains on divestiture of intangibles and other assets by Reynolds in 2016 are treated as adjusting items and therefore the additional tax charge of £61 million was also treated as adjusting. The adjusting tax item also includes the tax on adjusting items as discussed above.

4 CASH FLOW AND NET DEBT MOVEMENTS

(a) Alternative cash flow

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

	6 months to		Year to
	30.6.17	**30.6.16**	**31.12.16**
	£m	**£m**	**£m**
Adjusted profit from operations	**2,841**	2,452	5,480
Depreciation, amortisation and impairment	**204**	177	393
Other non-cash items in operating profit	**30**	17	62
Adjusted profit from operations before depreciation, amortisation and impairment	**3,075**	2,646	5,935
Increase in working capital	**(899)**	(1,017)	(254)
Net capital expenditure	**(187)**	(126)	(559)
Gross capital expenditure	**(210)**	(149)	(652)
Sale of fixed assets	**23**	23	93
Adjusted operating cash flow	**1,989**	1,503	5,122
Pension funds' shortfall funding	**(40)**	(40)	(78)
Net interest paid	**(326)**	(276)	(537)
Tax paid	**(547)**	(620)	(1,245)
Dividends paid to non-controlling interests	**(106)**	(94)	(147)
Cash generated from operations	**970**	473	3,115
Restructuring costs	**(220)**	(115)	(452)
Non-tobacco litigation: Fox River	**(2)**	(9)	(17)
Tobacco litigation: Quebec (deposit)	**(130)**	(114)	(242)
Dividends and other appropriations from associates	**465**	324	985
Free cash flow	**1,083**	559	3,389
Dividends paid to shareholders	**(2,179)**	(1,950)	(2,910)
Net investment activities	**(141)**	(130)	(166)
Net flow from net investment hedges, share schemes and other	**(325)**	(175)	(476)
Net cash flow	**(1,562)**	(1,696)	(163)
External movements on net debt			
Exchange rate effects*	**(79)**	(1,241)	(1,684)
Change in accrued interest and other	**(73)**	(4)	(126)
Change in net debt	**(1,714)**	(2,941)	(1,973)
Opening net debt	**(16,767)**	(14,794)	(14,794)
Closing net debt	**(18,481)**	(17,735)	(16,767)

* Including movements in respect of debt related derivatives.

Reconciliation of IFRS Cash Flow Statement to Alternative Cash Flow Statement			
Net cash generated from operating activities	**1,706**	1,054	4,610
Cash impact of adjusting items	**352**	238	711
Adjusted net cash generated from operating activities	**2,058**	1,292	5,321
Dividends paid to non-controlling interests	**(106)**	(94)	(147)
Net Interest paid	**(326)**	(276)	(537)
Net capital expenditure	**(187)**	(126)	(559)
Dividends from associates	**(465)**	(324)	(962)
Other	**(4)**	1	(1)
Cash generated from operations (above)	**970**	473	3,115
Note: Cash generated from operations at constant rates of exchange	**950**	473	

In the Group cash flow statement, cash generated from operations grew by 32.4%, driven by profit from operations earned in the period and a reduction in inventories. This more than offset a reduction in trade and other payables and the final quarterly payments in relation to the Quebec Class Action, discussed in note 10.

In the alternative cash flow presented above, adjusted operating cash flow grew by £486 million or 32.3% to £1,989 million, largely due to the growth in adjusted profit from operations, partly offset by an increase in capital expenditure related to the expansion of South Korea production facility and investment to support the NGP portfolio. Free cash flow grew by £524 million to £1,083 million driven by the increase in adjusted operating cash flow, lower taxation payments and an increase in dividends from associates.

The conversion of adjusted operating profit to adjusted operating cash flow was 70.0% (2016: 61.3%). The ratio of free cash flow per share to adjusted diluted earnings per share grew to 43.2% (2016: 27.0%).

Below free cash flow, the principal cash outflows for the six months to 30 June 2017 comprise the payment of the prior year final dividend which was £229 million higher at £2,179 million.

During 2017, the cash outflow from net investing activities was in line with prior year reflecting the acquisitions completed in the period.

The other net flows in 2017 principally relate to shares purchased by the employee share ownership trusts and cash flows in respect of certain derivative financial instruments.

These flows resulted in a net cash outflow of £1,562 million (2016: £1,696 million). After taking account of other changes, especially exchange rate movements, total net debt was £18,481 million at 30 June 2017 (30 June 2016: £17,735 million and 31 December 2016: £16,767 million).

(b) 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:

	6 months to		**Year to**
	30.6.17	**30.6.16**	**31.12.16**
	£m	**£m**	**£m**
Net debt due within one year:			
Borrowings	**5,822**	5,343	3,007
Related derivatives	**114**	(215)	(498)
Cash and cash equivalents	**(2,019)**	(1,882)	(2,204)
Current available-for-sale investments	**(26)**	(61)	(15)
	3,891	3,185	290
Net debt due beyond one year:			
Borrowings	**15,085**	14,888	16,488
Related derivatives	**(495)**	(338)	(11)
	14,590	14,550	16,477
Total net debt	**18,481**	17,735	16,767

The Group remains confident about its ability to access the debt capital markets successfully and reviews its options on a continuing basis.

(c) IFRS cash generated from operations

The cash generated from operating activities in the IFRS cash flows includes the following items:

	6 months to		**Year to**
	30.6.17	**30.6.16**	**31.12.16**
	£m	**£m**	**£m**
Profit from operations	**2,574**	2,213	4,655
Adjustments for:			
Depreciation, amortisation and impairment	**346**	253	607
Decrease/(Increase) in inventories	**539**	118	(638)
(Increase)/Decrease in trade and other receivables	**(151)**	219	87
Increase in amounts receivable in respect of the Quebec Class Action	**(130)**	(114)	(242)
(Decrease)/Increase in trade and other payables	**(1,312)**	(1,323)	428
Decrease in net retirement benefit liabilities	**(36)**	(81)	(145)
(Decrease)/Increase in provisions for liabilities and charges	**(74)**	2	141
Other non-cash items	**32**	63	—
Cash generated from operations	**1,788**	1,350	4,893

(d) IFRS net cash and cash equivalents

The net cash and cash equivalents in the IFRS Group cash flow statement comprise:

	6 months to		Year to
	30.6.17	**30.6.16**	**31.12.16**
	£m	**£m**	**£m**
Cash and cash equivalents per balance sheet	**2,019**	1,882	2,204
Overdrafts and accrued interest	**(609)**	(422)	(553)
Net cash and cash equivalents	**1,410**	1,460	1,651

(e) Liquidity

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

Historically, the Group has targeted an average centrally managed bond maturity of at least five years with no more than 20% of centrally managed debt maturing in a single rolling year. As at 30 June 2017, the average centrally managed debt maturity of bonds was 8.5 years (30 June 2016: 7.4 years; 31 December 2016: 8.2 years) and the highest proportion of centrally managed debt maturing in a single rolling 12-month period was 19.7% (30 June 2016: 17.8%; 31 December 2016: 18.1%).

In April 2017, the Group arranged short term bilateral facilities with some of its core banks for a total amount of approximately £1.6 billion equivalent. These facilities strengthen the Group's liquidity position and provide alternative sources of cost-effective short-term funding.

In June 2017, the Group repaid US$600 million and €1,250 million bonds at maturity.

In July 2017, following the shareholder vote and successful closing of the merger deal with Reynolds the Group drew on its acquisition facility provided by a syndicate of relationship banks: two bridge facilities of US$15 billion and US$5 billion maturing in 2018 and 2019 respectively (each with two six months extensions at BAT's option), US$2.5 billion term loan maturing in 2020 and US$2.5 billion term loan maturing in 2022. The Group intends to refinance the bridge facilities through debt issuance in the capital market in due course.

In addition, effective from closing date, the Group increased its liquidity backstop with a new two-tranche £5.7 billion revolving credit facility, which consists of a 364-day revolving credit facility of £2.84 billion (with a one year extension and one year term out option), and a £2.84 billion revolving credit facility maturing in 2021. They replace the Group's £3 billion revolving credit facility, which was undrawn as at 30 June 2017. The Group has also increased its US and euro commercial paper programmes from US$3 billion to US$4 billion and from £1 billion to £3 billion respectively to accommodate the liquidity needs of the enlarged Group. At 30 June 2017, £1,432 million of commercial paper was outstanding (30 June 2016: £1,705 million; 31 December 2016: £254 million).

On 19 July 2016, the Group exercised the make-whole provision for its US$700 million bond originally issued in 2008 pursuant to rule 144A. The bond was redeemed on 18 August 2016, prior to its original maturity date of 15 November 2018. This was undertaken to manage the Group's debt maturity profile, decrease future refinancing risk and reduce the on-going interest expense.

5 RELATED PARTY DISCLOSURES

Other than as previously included in this announcement, there were no other material changes in related parties or related party transactions. The Group's related party transactions and relationships for 2016 were disclosed in note 27 of the BAT Group's 2016 consolidated financial statements.

6 FOREIGN CURRENCIES

The principal exchange rates used were as follows:

	Average			Closing		
	30.6.17	**30.6.16**	**31.12.16**	**30.6.17**	**30.6.16**	**31.12.16**
Australian dollar	**1.670**	1.954	1.824	**1.693**	1.795	1.707
Brazilian real	**4.006**	5.308	4.740	**4.304**	4.283	4.022
Canadian dollar	**1.681**	1.907	1.795	**1.687**	1.736	1.657
Euro	**1.163**	1.284	1.224	**1.139**	1.203	1.172
Indian rupee	**82.766**	96.300	91.022	**83.961**	90.227	83.864
Japanese yen	**141.509**	159.892	147.466	**145.950**	137.142	144.120
Russian rouble	**73.005**	100.639	91.026	**76.987**	85.391	75.429
South African rand	**16.632**	22.075	19.962	**17.019**	19.577	16.898
US dollar	**1.260**	1.433	1.355	**1.299**	1.337	1.236

7 OTHER CHANGES IN THE GROUP

On 25 July 2017, the Group announced the completion of the acquisition of the remaining 57.8% of Reynolds not already owned by the Group for a consideration of £41.7 billion. Reynolds shareholders received, for each share of Reynolds common stock, US$29.44 in cash, without interest, and 0.5260 BAT ordinary shares which shall be represented by BAT ADSs listed on the New York Stock Exchange.

Reynolds ceased to be reported as an associate and will be consolidated as a wholly owned subsidiary as at the acquisition date.

IFRS 3 requires certain disclosures for material transactions, even if those transactions were completed after the balance sheet date. Given the short period of time since acquisition all estimates provided in relation to the disclosures are deemed to be provisional and will be updated in due course as permitted under IFRS 3.

The fair value table below, stated at the exchange rates ruling at the date of the transaction, has been based on available management information and work is continuing in respect of the fair value exercise and the necessary adjustments to determine acquired book values. The values shown in the table below are therefore provisional and the full table will be presented and updated in due course as permitted by IFRS 3.

Provisional values:

	Book values	Fair value adjustments	Estimated fair value
	£m	£m	£m
Intangible assets	**22,555**	**45,523**	**68,078**
Property, plant and equipment	**989**	**—**	**989**
Trade and other receivables	**379**	**—**	**379**
Inventories	**1,167**	**540**	**1,707**
Cash and cash equivalents	**1,345**	**—**	**1,345**
Borrowings	**(10,053)**	**(1,196)**	**(11,249)**
Retirement benefit liabilities	**(1,103)**	**—**	**(1,103)**
Deferred tax liabilities	**(7,498)**	**(18,229)**	**(25,727)**
Trade and other payables	**(1,566)**	**—**	**(1,566)**
Other provisions for liabilities and charges	**(1,486)**	**—**	**(1,486)**
Net identifiable assets acquired	**4,729**	**26,638**	**31,367**
Goodwill			**40,659**
Total			**72,026**
Being:			
Consideration paid to Reynolds shareholders (57.8%)			**41,717**
Value attributable to BAT shareholding (42.2%)			**30,309**
Total			**72,026**

If the acquisition had occurred on 1 January 2017, before accounting for anticipated synergy and restructuring benefits, it is currently estimated that Group revenue would have been £12,638 million and Group profit from operations would have been £4,081 million for the 6 months to 30 June 2017. This is after charging £26 million for the amortisation of acquired intangibles, an uplift to the fair value of inventory of £540 million and £212 million in respect of integration and acquisition costs.

During 2017, the Group acquired certain tobacco assets from Bulgartabac Holding AD in Bulgaria. The Group also acquired Winnington Holdings AB in Sweden and certain assets from Must Have Limited in the UK, including the electronic cigarette brand ViP. The financial impact of these transactions to the Group were immaterial individually and in aggregate.

8 EARNINGS PER SHARE

Basic earnings per share were 15.3% lower at 121.8p (2016: 143.8p) as the prior year benefited from the sale by Reynolds of the international rights to Natural American Spirit. Adjusted diluted earnings per share increased by 21.0% to 134.4p (2016: 111.1p), principally as a result of adjusted operating profit growth, higher adjusted profit from associates and the translational foreign exchange tailwind. At constant rates, adjusted diluted earnings per share increased by 6.2% to 118.0p (2016: 111.1p).

	6 months to		Year to
	30.6.17	30.6.16	31.12.16
	pence	pence	pence
Earnings per share			
– basic	**121.8**	143.8	250.2
– diluted	**121.4**	143.4	249.2
Adjusted earnings per share			
– basic	**134.9**	111.4	248.4
– diluted	**134.4**	111.1	247.5
Headline earnings per share			
– basic	**126.4**	99.5	205.6
– diluted	**126.0**	99.2	204.8

Basic earnings per share are based on the profit for the year attributable to ordinary shareholders and the weighted average number of ordinary shares in issue during the period (excluding treasury shares). For the calculation of the diluted earnings per share, the weighted average number of shares reflects the potential dilutive effect of employee share schemes.

The presentation of headline earnings per share, as an alternative measure of earnings per share, is mandated under the JSE Listing Requirements. It is calculated in accordance with Circular 2/2015 'Headline Earnings', as issued by the South African Institute of Chartered Accountants.

Adjusted diluted earnings per share and adjusted diluted earnings per share at constant rates of exchange are calculated by taking the following adjustments into account (see note 3):

	6 months to		Year to
	30.6.17	30.6.16	31.12.16
	pence	pence	pence
Unadjusted diluted earnings per share	**121.4**	143.4	249.2
Effect of restructuring and integration costs	**5.1**	7.1	27.5
Effect of amortisation of trademarks and similar intangibles	**6.4**	2.6	6.3
Effect of South Korea sales tax challenge	**—**	—	2.6
Effect of Fox River	**—**	1.1	1.1
Effect of associates' adjusting items	**(1.2)**	(45.1)	(48.3)
Effect of adjusting items in net finance costs	**2.7**	(1.1)	5.8
Effect of adjusting items in respect of deferred taxation	**—**	3.1	3.3
Adjusted diluted earnings per share	**134.4**	111.1	247.5
Effect of exchange rate movements	**(16.4)**		
Adjusted diluted earnings per share (at constant rates)	**118.0**		

Diluted headline earnings per share are calculated by taking the following adjustments into account:

	6 months to		Year to
	30.6.17	**30.6.16**	**31.12.16**
	pence	**pence**	**pence**
Unadjusted diluted earnings per share	**121.4**	143.4	249.2
Effect of impairment of intangibles and property, plant and equipment and held-for-sale assets	**3.2**	1.2	4.9
Effect of gains on disposal of property, plant and equipment and held-for-sale assets	**(0.4)**	—	(1.6)
Effect of share of associates' gain on disposal of held-for-sale assets	**1.8**	(44.6)	(47.1)
Effect of issue of shares and change in shareholding in associate	**—**	(0.7)	(0.6)
Other	**—**	(0.1)	—
Diluted headline earnings per share	**126.0**	99.2	204.8

The earnings per share are based on:

	30.6.17		30.6.16		31.12.16	
	Earnings	**Shares**	**Earnings**	**Shares**	**Earnings**	**Shares**
	£m	**m**	**£m**	**m**	**£m**	**m**
Earnings per share						
– basic	**2,261**	1,858	2,671	1,858	4,648	1,858
– diluted	**2,261**	1,863	2,671	1,863	4,648	1,865
Adjusted earnings per share						
– basic	**2,505**	1,858	2,070	1,858	4,615	1,858
– diluted	**2,505**	1,863	2,070	1,863	4,615	1,865
– diluted, at constant rates	**2,198**	1,863				
Headline earnings per share						
– basic	**2,346**	1,858	1,849	1,858	3,819	1,858
– diluted	**2,346**	1,863	1,849	1,863	3,819	1,865

9 DIVIDENDS

Declaration

The Board has declared an interim dividend of 56.5 pence per ordinary share of 25p for the six months ended 30 June 2017. The interim dividend will be payable on 28 September 2017 to shareholders registered on either the UK main register or the South Africa branch register on 18 August 2017 (the record date). For holders of ADSs listed on the NYSE, the record date is also 18 August 2017 with a payment date of 3 October 2017. The equivalent interim dividend receivable by holders of ADSs in US dollars will be calculated based on the exchange rate on 28 September 2017. A fee of USD0.01 per ADS will be charged by Citibank, N.A. in its capacity as depositary bank for the BAT American Depositary Receipt ("ADR") programme in respect of this dividend.

Key Dates

In compliance with the requirements of the London Stock Exchange ("LSE"), the NYSE and Strate, the electronic settlement and custody system used by the JSE Limited ("JSE"), the following salient dates for the payment of the interim dividend are applicable:

Event	Date 2017
Last Day to Trade ("LDT") cum dividend (JSE)	Tuesday 15 August
Shares commence trading ex dividend (JSE and NYSE)	Wednesday 16 August
Shares commence trading ex dividend (LSE)	Thursday 17 August
Record date (JSE, LSE and NYSE)	Friday 18 August
Payment date (LSE and JSE)	Thursday 28 September
ADS Payment date (NYSE)	Tuesday 3 October
No removal requests permitted between the UK main register and the South Africa branch register	Thursday 27 July to Friday 18 August (inclusive)
No transfers permitted between the UK main register and the South Africa branch register; no shares may be dematerialised or rematerialised	Wednesday 16 August to Friday 18 August (inclusive)

As the Group reports in sterling, dividends are declared and payable in sterling except for shareholders on the branch register in South Africa whose dividends are payable in rand. A rate of exchange of £:R = 17.00160 as at 25 July 2017 (the closing rate on that date as quoted by Bloomberg), results in an equivalent interim dividend of 960.59040 SA cents per ordinary share.

South Africa Branch Register: Dividends Tax Information

South Africa Dividends Tax (at a rate of 20%), equivalent to 192.11808 SA cents per ordinary share, will be withheld from the gross interim dividend paid to shareholders on the South Africa branch register, unless a shareholder qualifies for an exemption. After Dividends Tax has been withheld, the net dividend will be 768.47232 SA cents per ordinary share. The interim dividend is regarded as a 'foreign dividend' for the purposes of the South Africa Dividends Tax. For the purposes of South Africa Dividends Tax reporting, the Country of Income Source ("COIN") for the payment of the interim dividend is the United Kingdom.

At the close of business on 25 July 2017 (the latest practicable date prior to the date of the declaration of the interim dividend), British American Tobacco p.l.c. (the "Company") had a total of 2,293,506,044 ordinary shares in issue (excluding treasury shares). The Company held 162,645,590 ordinary shares in treasury giving a total issued share capital of 2,456,151,634 ordinary shares.

British American Tobacco p.l.c. is registered with the South African Revenue Service (SARS) with tax reference number 9378193172.

For the avoidance of doubt, Dividends Tax and the information provided above is of only direct application to shareholders on the South Africa branch register. Shareholders on the South Africa branch register should direct any questions regarding the application of Dividends Tax to Computershare Investor Services Proprietary Limited, contact details for which are given in the 'Corporate Information' section below.

10 CONTINGENT LIABILITIES AND FINANCIAL COMMITMENTS

The Group has contingent liabilities in respect of litigation, taxes and guarantees in various countries, as described in Note 28 to the BAT Group's 2016 consolidated financial statements. 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.

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.

Taxes

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, among others, excise tax, value-added taxes, sales taxes, corporate taxes, withholding taxes and payroll taxes.

The estimated costs of known tax obligations have been provided in these accounts in accordance with 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.

There are disputes that may proceed to litigation in a number of countries including Brazil, South Africa and Netherlands. A dispute in Bangladesh, which proceeded to litigation in 2014, is on-going, whilst the Group is appealing the ruling in respect of sales taxes and penalties in South Korea.

Group litigation

Group companies, as well as other leading cigarette manufacturers, are defendants in a number of product liability cases. In a number of the cases, the amounts of compensatory and punitive damages sought are significant.

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 that could in some cases equal or exceed the amount of the judgment. 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 a particular period could be materially affected by this and by the final outcome of any particular litigation.

In respect of the two class actions against the Group's subsidiary Imperial Tobacco Canada ("ITCAN") in Quebec, in 2015 the Quebec Court of Appeal upheld the Order for Security, of which ITCAN's share is CAD $758 million. During the period ended 30 June 2017, ITCAN made the final two quarterly deposits (£130 million, CAD $216 million) to the Court escrow account as required by the judgment. ITCAN continues to retain strong legal grounds to appeal the original judgment. No charge against profit has been made with regards to the deposit, as ITCAN continues to assess that the deposits are fully recoverable upon a successful appeal of the original judgment.

Georgian Competition Claim

In July 2016, OGT Ltd ("OGT"), a Georgian tobacco manufacturer, filed a claim in the Tbilisi City Court against British American Tobacco Georgia Limited ("BAT Georgia"), BAT Georgia's Representative Office in Tbilisi, and BAT Georgia's exclusive distributor in Georgia alleging anti-competitive practices. BAT Georgia denied the allegations. In January 2017, OGT filed a revised pleading claiming damages of approximately US$101 million. BAT Georgia and its Representative Office filed a revised defence again denying the allegations and bringing a counterclaim. On 10 February 2017, judgment was entered against BAT Georgia for US $100,537,172, and dismissing BAT Georgia's counterclaim. On 8 June 2017, the Tbilisi Court of Appeals overturned the judgment against BAT Georgia, but upheld the dismissal of BAT Georgia's counterclaim. It is open to OGT to seek to appeal to the Georgian Supreme Court.

Summary

Having regard to all these matters, with the exception of Fox River, the Group (i) does not consider it appropriate to make any provision or charge in respect of any pending litigation and (ii) does not believe that the ultimate outcome of this litigation will significantly impair the Group's financial condition.

Full details of the litigation against Group companies and tax disputes as at 31 December 2017 will be included in the Annual Report for the year ended 31 December 2017. There were no material developments in 2016 that would impact on the financial position of the Group.

11 FRANKED INVESTMENT INCOME GROUP LITIGATION ORDER

The Group is the principal test claimant in an action in the United Kingdom against HM Revenue and Customs ("HMRC") in the FII GLO. There are 25 corporate groups in the FII GLO. The case concerns the treatment for UK corporate tax purposes of profits earned overseas and distributed to the UK. Full details are provided in note 6(b) of the BAT Group's 2016 consolidated financial statements.

The original claim was filed in 2003. The trial of the claim was split broadly into issues of liability and quantification. The main liability issues were heard by the High Court, Court of Appeal and Supreme Court in the UK and the European Court of Justice in the period to November 2012. The detailed technical issues of the quantification mechanics of the claim were heard by the High Court during May and June 2014 and the judgment handed down on 18 December 2014. The High Court determined that in respect of issues concerning the calculation of unlawfully charged corporation tax and advance corporation tax, the law of restitution including the defence on change of position and questions concerning the calculation of overpaid interest, the approach of the Group was broadly preferred. The conclusion reached by the High Court would, if upheld, produce an estimated receivable of £1.2 billion for the Group. Appeals on a majority of the issues were made to the Court of Appeal, which heard the arguments in June 2016. The Court of Appeal determined in November 2016 on the majority of issues that the conclusion reached by the High Court should be upheld. The outcome of the Court of Appeal has not reduced the estimated receivable. Permission has been sought by HMRC to appeal almost all issues on which it was unsuccessful to the Supreme Court.

During 2015, HMRC paid to the Group a gross amount of £1,224 million in two separate payments. The payments made by HMRC have been made without any admission of liability and are subject to refund were HMRC to succeed on appeal. The second payment in November 2015 followed the introduction of a new 45% tax on the interest component of restitution claims against HMRC. HMRC held back £261 million from the second payment contending that it represents the new 45% tax on that payment, leading to total cash received by the Group of £963 million. Actions challenging the legality of the withholding of the 45% tax have been lodged and the Group's appeal is proceeding as the lead case from those appeals. The First Tier Tribunal found in favour of HMRC in July 2017 and the Group will now seek permission to appeal to the Upper Tribunal.

Due to the uncertainty of the amounts and eventual outcome the Group has not recognised any impact in the Income Statement in the current or prior period in respect of the receipt which, net of the deduction by HMRC, is held as deferred income. Any future recognition as income will be treated as an adjusting item, due to the size of the order, with interest of £12 million for the six months to 30 June 2017 (30 June 2016: £12 million, 31 December 2016: £25 million) accruing on the balance, which was also treated as an adjusting item.

12 FAIR VALUE MEASUREMENTS AND VALUATION PROCESSES

The Group held certain financial instruments at fair value at 30 June 2017. The definitions and valuation techniques employed for these as at 30 June 2017 are consistent with those used at 31 December 2016 and disclosed in Note 23 of the BAT Group's 2016 consolidated financial statements:

– Level 1 financial instruments are traded in an active market and fair value is based on quoted prices at the period end.

– Level 2 financial instruments are not traded in an active market, but the fair values are based on quoted market prices, broker/dealer quotations, or alternative pricing sources with reasonable levels of price transparency. The Group's level 2 financial instruments include OTC derivatives.

– The fair values of level 3 financial instruments have been determined using a valuation technique where at least one input (which could have a significant effect on the instrument's valuation) is not based on observable market data. The Group's level 3 financial instruments primarily consist of an equity investment in an unquoted entity which is valued using the discounted cash flows of estimated future dividends.

While the carrying values of assets and liabilities at fair value have changed since 31 December 2016, the Group does not consider the movements in value to be significant, and the categorisation of these assets and liabilities in accordance with the disclosure requirements of IFRS 7 has not materially changed. The values of level 1 assets and level 3 assets are not material to the Group and were £26 million and £44 million respectively at 30 June 2017 (30 June 2016: £61 million and £42 million respectively and 31 December 2016: £15 million and £43 million respectively).

Level 2 assets and liabilities are shown below.

	30.6.2017	30.6.2016	31.12.2016
	Level 2	Level 2	Level 2
	£m	£m	£m
Assets at fair value			
Derivatives relating to			
– interest rate swaps	**209**	349	252
– cross-currency swaps	**528**	501	540
– forward foreign currency contracts	**151**	345	179
Assets at fair value	**888**	1,195	971
Liabilities at fair value			
Derivatives relating to			
– interest rate swaps	**212**	120	104
– cross-currency swaps	**132**	212	174
– forward foreign currency contracts	**209**	728	390
Liabilities at fair value	**553**	1,060	668

The fair value of borrowings is estimated to be £21,718 million (30 June 2016: £19,586 million and 31 December 2016: £20,592 million) and has been determined using quoted market prices or discounted cash flow analysis. The value of other assets/liabilities held at amortised cost are not materially different from their fair values.

13 NET FINANCE (COSTS)/INCOME

Net finance costs for the six months to 30 June 2017 was £325 million, compared to £233 million in the same period last year. Net adjusted finance costs increased by 9.1% largely driven by the impact of the devaluation of sterling on the reported results. At constant rates, net adjusted finance costs were in line with the prior year.

Net finance (costs)/income comprise:

	6 months to		Year to
	30.6.17	30.6.16	31.12.16
	£m	£m	£m
Finance costs	**(381)**	(260)	(681)
Finance income	**56**	27	44
	(325)	(233)	(637)
Less: adjusting items	**49**	(20)	108
Make-whole provision re early redemption of bond	**—**	—	101
Hedge ineffectiveness	**10**	(32)	(18)
Interest related to Franked Investment Income Group Litigation Order ("FII GLO")	**12**	12	25
Acquisition of Reynolds	**27**	—	—
Net adjusted finance costs	**(276)**	(253)	(529)
Comprising:			
Interest payable	**(347)**	(325)	(650)
Interest and dividend income	**36**	27	68
Fair value changes — derivatives	**82**	344	458
Exchange differences	**(47)**	(299)	(405)
Net adjusted finance costs	**(276)**	(253)	(529)

In the 6 months ended 30 June 2017, the Group incurred £27 million of financing costs related to the acquisition of the shares not already owned by the Group in Reynolds, as described in note 7. As this related to the pre-financing of the acquisition, and will not repeat, the costs have been treated as an adjusting item.

In 2016, the Group experienced hedge ineffectiveness on its external swaps, driven by the market volatility following the "Brexit" referendum. In 2017, the charge of £10 million reflects the continued reversal of the gain recognised in 2016 which was deemed to be adjusting as it is not representative of the underlying performance of the business.

On 19 July 2016, the Group redeemed a US$700 million bond, prior to its original maturity date of 15 November 2018, undertaken to manage the Group's debt maturity profile, manage future refinancing risk and reduce the on-going interest expense. This led to a loss in the year of £101 million which has been treated as an adjusting item.

In 2015, as described in note 11, the Group received £963 million from HM Revenue & Customs in relation to the FII GLO. The payment was received subject to the on-going appeals process and was made with no admission of liability. Any future repayment by the Group is subject to interest and, as any recognition of income will be deemed to be adjusting (due to size), interest of £12 million (30 June 2016: £12 million, 31 December 2016: £25 million) has been accrued in the period and treated as an adjusting item.

All of the above have been included in the adjusted earnings per share calculation in note 8.

14 RESULTS OF ASSOCIATES AND JOINT VENTURES

The Group's share of post-tax results of associates and joint ventures fell by £668 million to £778 million. The decrease was principally due to the one-off contribution from the sale by Reynolds of the international rights to Natural American Spirit in 2016. The Group's share of the adjusted post-tax results of associates and joint ventures increased 25.0% to £756 million, with a rise of 9.3% to £661 million at constant rates of exchange.

The adjusted contribution from Reynolds increased by 26.1% to £556 million. At constant rates of exchange the increase was 10.7%. The Group's adjusted contribution from its main associate in India, ITC Ltd. (ITC), was £195 million, up 25.8%. At constant rates of exchange, the contribution would have been 7.7% higher than last year. See note 3(d) for the adjusting items.

15 TAXATION

	6 months to		Year to
	30.6.17	**30.6.16**	**31.12.16**
	£m	**£m**	**£m**
UK			
– current year tax	**12**	4	7
Overseas			
– current year tax expense	**635**	573	1,382
– adjustment in respect of prior periods	**5**	4	13
Current tax	**652**	581	1,402
Deferred tax	**28**	104	4
	680	685	1,406
Adjusting items (see below)	**48**	(27)	67
Net adjusted tax charge	**728**	658	1,473

The tax rate in the income statement of 22.5% for the six months to 30 June 2017 (30 June 2016: 20.0%, 31 December 2016: 22.5%) is affected by the inclusion of the share of associates' and joint ventures' 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 in note 8 was 28.4% in 2017 and 29.9% for the six months to 30 June 2016. For the year to 31 December 2016, it was 29.8%.

International Financial Reporting Standards as adopted by the European Union ("IFRS") requires entities to provide deferred taxation on the undistributed earnings of associates and joint ventures. In 2016, the Group's share of the gain on the sale of the international rights to Natural American Spirit by Reynolds to Japan Tobacco International ("JTI") was recognised as an adjusting item by the Group. Accordingly, the additional deferred tax charge on the potential distribution of these undistributed earnings (30 June 2016: £58 million, 31 December 2016: £61 million) has also been treated as adjusting.

The adjusting tax item also includes £48 million for the six months to 30 June 2017 (30 June 2016: £29 million, 31 December 2016: £128 million) in respect of the tax on adjusting items, as described in note 3.

Refer to note 11 for the Franked Investment Income Group Litigation Order update.

NOTES AND ADDITIONAL INFORMATION

British American Tobacco is one of the world's leading consumer products businesses, with brands sold in more than 200 markets. We have five Global Drive Brands – Dunhill, Kent, Lucky Strike, Pall Mall and Rothmans – and over 200 brands in our portfolio, including a growing portfolio of Next Generation Products. We hold robust market positions in each of our regions and have leadership positions in more than 55 markets.

Forward looking statements

This announcement contains certain forward-looking statements, including "forward-looking" statements made within the meaning of Section 21E of the United States Securities Exchange Act of 1934. These statements are often, but not always, made through the use of words or phrases such as "believe," "anticipate," "could," "may," "would," "should," "intend," "plan," "potential," "predict," "will," "expect," "estimate," "project," "positioned," "strategy," "outlook" and similar expressions. These include statements regarding our intentions, beliefs or current expectations concerning, amongst other things, our results of operations, financial condition, liquidity, prospects, growth, strategies and the economic and business circumstances occurring from time to time in the countries and markets in which the Group operates.

All such forward-looking statements involve estimates and assumptions that are subject to risks, uncertainties and other factors that could cause actual future financial condition, performance and results to differ materially from the plans, goals, expectations and results expressed in the forward-looking statements and other financial and/or statistical data within this communication. Among the key factors that could cause actual results to differ materially from those projected in the forward-looking statements are uncertainties related to the following: the failure to realize contemplated synergies and other benefits from mergers and acquisitions, including the merger of RAI and BAT; the effect of mergers, acquisitions and divestitures, including the merger of RAI and BAT, on BAT's operating results and businesses generally; the ability to maintain credit ratings; changes in the tobacco industry and stock market trading conditions; changes or differences in domestic or international economic or political conditions; changes in tax laws and rates; the impact of adverse legislation and regulation; the ability to develop, produce or market new alternative products profitably; the ability to effectively implement strategic initiatives and actions taken to increase sales growth; the ability to enhance cash generation and pay dividends; adverse litigation and dispute outcomes; and changes in the market position, businesses, financial condition, results of operations or prospects of BAT.

It is believed that the expectations reflected in this announcement are reasonable but they may be affected by a wide range of variables that could cause actual results to differ materially from those currently anticipated. Past performance is no guide to future performance and persons needing advice should consult an independent financial adviser. The forward-looking statements reflect knowledge and information available at the date of preparation of this announcement and the Company undertakes no obligation to update or revise these forward-looking statements, whether as a result of new information, future events or otherwise. Nothing in this document should be construed as a profit forecast. Readers are cautioned not to place undue reliance on such forward-looking statements.

Additional information concerning these and other factors can be found in BAT's and RAI's filings with the U.S. Securities and Exchange Commission ("SEC"), including RAI's most recent Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q and Current Reports on Form 8-K and BAT's registration statement on Form F-4, which was declared effective by the SEC on June 14, 2017, and Current Reports on Form 6-K, which may be obtained free of charge at the SEC's website, http://www.sec.gov, and BAT's Annual Reports, which may be obtained free of charge from BAT's website www.BAT.com.

No statement in this communication is intended to be a profit forecast and no statement in this communication should be interpreted to mean that earnings per share of BAT for the current or future financial years would necessarily match or exceed the historical published earnings per share of BAT.

Non-solicitation

This announcement does not constitute an offer or the solicitation of an offer to underwrite, subscribe for, or otherwise acquire or dispose of any British American Tobacco p.l.c. shares or other securities, nor shall there be any sale of such securities in any jurisdiction in which such offer, solicitation or sale would be unlawful prior to registration or qualification under the securities laws of any such jurisdiction. No offer of securities shall be made except by means of a prospectus meeting the requirements of Section 10 of the Securities Act of 1933, as amended (the "Securities Act"), or pursuant to an exemption from the registration requirement under Section 5 of the Securities Act.

PUBLICATION OF HALF-YEAR REPORT

This Half-Year Report is released or otherwise made available or notified to the London Stock Exchange, the JSE Limited and the New York Stock Exchange and filed in accordance with applicable regulations. It may be viewed and downloaded from our website www.bat.com.

Copies of the announcement may also be obtained during normal business hours from: (1) the Company's registered office; (2) the Company's representative office in South Africa; and (3) British American Tobacco Publications, as below.

ANNUAL REPORT: Statutory Accounts

The information for the year ended 31 December 2016 does not constitute statutory accounts as defined in s434 of the Companies Act 2006. A copy of the statutory accounts for that year 2016 has been delivered to the Registrar of Companies. The auditor's report on the 2016 accounts was unmodified, did not draw attention to any matters by way of emphasis and did not contain statements under s498(2) or (3) of the Companies Act 2006.

Paul McCrory
Secretary
26 July 2017

Level 2 assets and liabilities are shown below.

	30.6.2017	30.6.2016	31.12.2016
	Level 2	Level 2	Level 2
	£m	£m	£m
Assets at fair value			
Derivatives relating to			
- interest rate swaps	**209**	349	252
- cross-currency swaps	**528**	501	540
- forward foreign currency contracts	**151**	345	179
Assets at fair value	**888**	1,195	971
Liabilities at fair value			
Derivatives relating to			
- interest rate swaps	**212**	120	104
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The fair value of borrowings is estimated to be £21,718 million (30 June 2016: £19,586 million and 31 December 2016: £20,592 million) and has been determined using quoted market prices or discounted cash flow analysis. The value of other assets/liabilities held at amortised cost are not materially different from their fair values.

Independent auditor's report
To the members of British American Tobacco p.l.c. only

Opinions and conclusions arising from our audit

1 Our opinion on the financial statements is unmodified

We have audited the financial statements of British American Tobacco p.l.c. for the year ended 31 December 2016 which comprise the Group Income Statement, the Group Statement of Comprehensive Income, the Group and Parent Company Statements of Changes in Equity, the Group and Parent Company Balance Sheets, the Group Cash Flow Statement and the related notes. In our opinion:

- the financial statements give a true and fair view of the state of the Group's and of the Parent Company's affairs as at 31 December 2016 and of the Group's profit for the year then ended;
- the Group financial statements have been properly prepared in accordance with International Financial Reporting Standards as adopted by the European Union;
- the Parent Company financial statements have been properly prepared in accordance with UK Accounting Standards, including FRS 101 Reduced Disclosure Framework; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006; and, as regards the Group financial statements, Article 4 of the IAS Regulation.

2 Our assessment of risks of material misstatement

In arriving at our audit opinion above on the financial statements, the risks of material misstatement that had the greatest effect on our audit, in decreasing order of audit significance, were as follows:

Provisions and contingent liabilities in respect of litigations (non-corporate tax related)

Refer to page 42 (Audit Committee report), page 97 (accounting policy) and pages 131, 141–149 (financial disclosures)

The risk:

Dispute Outcome: The Group is subject to a large volume of claims including class actions, which could have a significant impact on the results if the potential exposures were to materialise. The Directors apply a number of judgements when considering whether, and how much, to provide for the potential exposure of each litigation. These include assumptions relating to the likelihood and/or timing of cash outflows from the business and the interpretation of local pending or preliminary court rulings in assessing whether provision arises. We placed specific focus on the judgments in respect of the ongoing smoking and health litigation brought against the operating company in Canada which is disclosed in note 28.

Our response:

Our procedures included:

- Control Design: Evaluation of the processes and controls over litigations operated by management at a Group, regional and local level through regular meetings with in-house legal counsels and review of Board and sub-committee meeting minutes;
- Enquiry and circularisation of lawyers: For all significant legal disputes, assessment of correspondence with the Group's external counsel accompanied by formal confirmations from that external counsel and discussions with in-house counsel;
- Accounting analysis: Use of KPMG legal specialists to assess relevant historical and recent judgments passed by the court authorities, as well as the formal confirmations of current stats from external counsel, in order to challenge the basis used for the accounting treatment and resulting disclosures; and
- Assessing transparency: Assessment of the Group's contingent liabilities disclosures in note 28 to determine whether management have presented the facts and circumstances clearly and accurately.

Global taxation exposures

Refer to page 42 (Audit Committee report), page 94 (accounting policy) and pages 105–106 and 149–150 (financial disclosures)

The risk:

Dispute Outcome: The Group operates in a complex multinational tax environment and has a number of uncertain tax positions. The tax matters are at various stages, from preliminary discussions with tax authorities through to tax tribunal or court proceedings where the matters can take many years to resolve. A number of significant judgements are made by the Directors in assessing whether any contingent liability or provision arises from disputes in particular in Brazil, Canada, South Africa and the Netherlands.

Our response:

Our procedures included:

- Own tax expertise: Use of our own international and local tax specialists to assess the Group's tax positions, its correspondence with the relevant tax authorities, and to analyse and challenge the assumptions used to determine tax provisions or contingent liability disclosure based on our knowledge and experience of the application of the international and local legislation by the relevant authorities and courts. In respect of the most significant disputes, we read recent rulings and correspondence with local tax authorities, as well as external advice received by the Group where relevant, to satisfy ourselves that the tax exposures had been appropriately provided for or determined to be contingent liabilities; and
- Assessing transparency: We assessed the adequacy of the Group's disclosures in respect of uncertain tax positions.

Goodwill impairment

Refer to page 94 (accounting policy) and pages 109–110 (financial disclosures)

The risk:

Forecast-based valuation: Goodwill is carried, principally relating to the acquisitions of Rothmans, Imperial Tobacco Canada, ETI (Italy), ST (Scandinavia) and Bentoel (Indonesia). There is significant judgement with regard to assumptions and estimates involved in forecasting future cash flows, which form the basis of the assessment of the recoverability of goodwill balances. These include budgeted volumes, operating margin, long-term growth rates and with regard to the discount rate used. This is particularly so in regions where BAT operations are new or developing, or where there are challenging economic or legislative factors. In the current year, the cash generating units with the lowest headroom, and therefore requiring particular attention were Indonesia (goodwill of £186 million), TDR Croatia (goodwill of £121 million) and Colombia (goodwill of £106 million).

Our response:

Our procedures included:

- Control design: Assessing the Group's budgeting review and approval procedures upon which the cash flow forecasts are based;
- Our sector experience: Evaluating assumptions used, in particular those relating to forecast revenue growth and profit margins in Indonesia, Croatia, and Colombia, as well as the discount rates, including using our own valuation specialists;
- Benchmarking assumptions: Comparing the Group's assumptions to externally derived data in relation to key inputs such as projected economic growth, competition, and discount rates. To challenge the reasonableness of the assumptions we also assessed the historical accuracy of the Group's forecasting;
- Sensitivity analysis: Performing scenario-specific models including changes to, and breakeven analysis on, the discount rate, long term growth rates and forecast cash flows;
- Comparing valuations: Comparing the sum of the discounted cash flows to the Group's market capitalisation to assess the reasonableness of those cash flows; and
- Assessing transparency: Assessing whether the Group's disclosures about the sensitivity of the outcome of the impairment assessment to changes in key assumptions reflected the risks inherent in the valuation of goodwill.

Removal of risk in respect of the IT System change (TaO)

We continue to monitor, and perform procedures over, the Group's implementation of its revised Operating Model and single IT system in a number of markets during the course of the year. However, given the number of end market system migrations has reduced significantly in comparison to the prior year, we have not assessed this as one of the risks that had the greatest effect on our audit and, therefore, it is not separately identified in our report this year.

3 Our application of materiality and an overview of the scope of our audit

Application of Materiality

Materiality for the Group financial statements as a whole was set at £245 million (2015: £245 million), determined with reference to a benchmark of Group profit before taxation normalised to exclude a current year one-off gain of £941 million in relation to the Group's share of the gain made by Reynolds American Inc. ("Reynolds American") on the sale of the international rights of Natural American Spirit. This represents 4.6% (2015: 5.0%) of the Group's reported profit before taxation as normalised. For those items excluded from normalised Group profit before tax, the component teams performed procedures on items relating to their components.

We report to the Audit Committee any corrected or uncorrected identified misstatements relating to Income Statement accounts exceeding £12 million and relating to Balance Sheet classification exceeding £50 million, in addition to other identified misstatements that warrant reporting on qualitative grounds.

Scope of our audit

In establishing the overall audit approach, we considered the centralised nature of the Group's operations, the risk profile of countries where the Group operates, and changes taking place within the business. We also considered the financial significance of each business unit together with any local statutory audit requirements.

The Group has three centralised shared service centres (2015: four) in Malaysia, Costa Rica and Romania that perform accounting and reporting activities, and together these shared service centres process a substantial portion of the Group's transactions. The outputs from the centralised shared service centres are included in the financial information of the end market entities they service. Each of the shared service centres was subject to specified audit procedures, primarily to test the effectiveness of the financial controls that they operate.

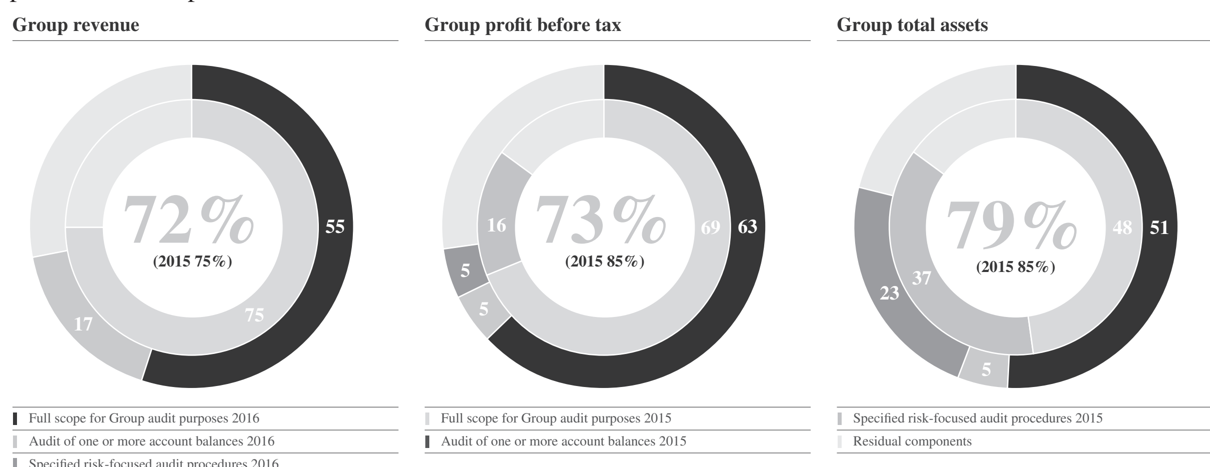
The Group has substantially completed the roll-out of a single IT operating system (TaO) which is subject to General IT Controls testing by the Group audit team.

The Group operates through a significant number of legal entities, which form end market and corporate reporting components primarily structured across four geographic regions, being Asia-Pacific; Americas; Western Europe; and Eastern Europe, Middle East and Africa. To provide sufficient coverage over the Group's significant risks, KPMG component auditors performed audits for Group reporting purposes of 28 end market and corporate reporting components (2015: 42 components). One of these components was an associate of the Group and one is the Parent Company. Audits of these components were performed using materiality levels assigned by the Group audit team, which were lower than the materiality level for the Group as a whole, ranging from £1 million to £163 million (2015: £2 million to £105 million), and determined by reference to the size and risk profile of the components.

Audits of one or more account balances were performed in respect of a further 13 end market and corporate reporting components (2015: nil), using a materiality of £20 million assigned by the Group audit team. This included the audit of revenue, accounts receivable and cash for 11 end market components, and the risk-based audit of selected balances and transactions for a further two corporate reporting components. These 13 components were not individually significant enough to require an audit for Group reporting purposes but were included in the scope of our Group reporting work in order to provide further coverage over the Group's revenue and total assets. This is a new approach for 2016. In 2015 specified risk-focused audit procedures were performed by Group and component auditors on certain balances and transactions in respect of three end market components, one of which was an associate.

Specified risk-focused audit procedures have been performed at a corporate level by the engagement team in London in relation to the Group consolidation and associated journal entries and financial statement disclosures. Additionally, supplemental procedures over and above those reported by component auditors have been performed in relation to a number of complex items including, taxation, pensions, litigation, treasury, goodwill and intangible asset impairment and earnings per share. This is consistent with 2015.

The percentages of the Group's revenue, the total profits and losses that make up the Group's profit before taxation and the Group's total assets represented by the components within the scope of our work and procedures performed at corporate level are as follows:



The remaining 28% (2015: 25%) of total Group revenue, 27% (2015: 15%) of the total profits and losses that made up the Group profit before tax and 21% (2015: 15%) of Group total assets is represented by over 230 reporting components, none of which individually represented more than 1.4% of any of total Group revenue, total profits and losses that made up the Group profit before tax or total Group assets. For the remaining components, we performed analysis at an aggregated Group level to re-examine our assessment that there were no significant risks of material misstatement within these.

Detailed audit instructions were sent to all auditors of in-scope end-market components and associates. These instructions covered the significant audit areas that we required to be covered by these auditors (which included the relevant risks of material misstatement detailed above) and set out the information required to be reported back to the Group audit team.

The Group audit team visited component locations subject to audit in Brazil, Canada, Indonesia, Japan, Malaysia, Croatia (TDR), the Netherlands, Romania, two visits to Reynolds American, as well as visits to the shared service centres in Romania, Malaysia and Costa Rica. In addition to these visits, the Group team also held telephone and/or online meetings as part of the audit planning phase to explain our audit instructions and discuss the component auditors' plans. The findings reported to the Group audit team were discussed in more detail with component auditors as necessary, and any further work required by the Group audit team was then performed by the component auditor.

4 Our opinion on other matters prescribed by the Companies Act 2006 is unmodified

In our opinion:

- the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006; and
- the information given in the Strategic Report and the Directors' Report for the financial year is consistent with the financial statements.

Based solely on the work required to be undertaken in the course of the audit of the financial statements and from reading the Strategic Report and the Directors' Report:

- We have not identified material misstatements in those reports; and
- In our opinion, those reports have been prepared in accordance with the Companies Act 2006

5 We have nothing to report on the disclosures of principal risks

Based on the knowledge we acquired during our audit, we have nothing material to add or draw attention to in relation to:

- the Directors' Statement of viability on page 26, concerning the principal risks, their management, and, based on that, the Directors' assessment and expectations of the Group's continuing in operation over the three years to 2019; or

- the disclosures in page 25 of the financial statements concerning the use of the going concern basis of accounting.

6 We have nothing to report in respect of the matters on which we are required to report by exception

Under ISAs (UK and Ireland) we are required to report to you if, based on the knowledge we acquired during our audit, we have identified other information in the Annual Report that contains a material inconsistency with either that knowledge or the financial statements, a material misstatement of fact, or that is otherwise misleading.

In particular, we are required to report to you if:

- we have identified material inconsistencies between the knowledge we acquired during our audit and the Directors' Statement that they consider that the Annual Report and financial statements taken as a whole is fair, balanced and understandable, and provides the information necessary for shareholders to assess the Group's position and performance, business model and strategy; or
- the section of the Annual Report on page 42 describing the work of the Audit Committee does not appropriately address matters communicated by us to the Audit Committee.

Under the Companies Act 2006 we are required 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 Directors' 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.

Under the Listing Rules we are required to review:

- the Directors' statements, set out on pages 25–26, in relation to going concern and longer-term viability; and
- the part of the Corporate Governance Statement on page 31 relating to the Company's compliance with the eleven provisions of the 2014 UK Corporate Governance Code specified for our review.

We have nothing to report in respect of the above responsibilities.

Scope and responsibilities

As explained more fully in the Directors' Responsibilities Statement set out on page 83, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. A description of the scope of an audit of financial statements is provided on the Financial Reporting Council's website at www.frc.org.uk/auditscopeukprivate. This report is made solely to the Company's members as a body and is subject to important explanations and disclaimers regarding our responsibilities, published on our website at www.kpmg.com/uk/auditscopeukco2014a, which are incorporated into this report as if set out in full and should be read to provide an understanding of the purpose of this report, the work we have undertaken and the basis of our opinions.

Mark Baillache (Senior Statutory Auditor)
for and on behalf of KPMG LLP, Statutory Auditor

Chartered Accountants

15 Canada Square

London, E14 5GL

22 February 2017

Group Income Statement
For the year ended 31 December

	Notes	2016 £m	2015 £m
Gross turnover (including duty, excise and other taxes of £32,136 million (2015: £27,896 million))		**46,887**	41,000
Revenue	2	**14,751**	13,104
Raw materials and consumables used		**(3,777)**	(3,217)
Changes in inventories of finished goods and work in progress		**44**	184
Employee benefit costs	3(a)	**(2,274)**	(2,039)
Depreciation, amortisation and impairment costs	3(b)	**(607)**	(428)
Other operating income		**176**	225
Other operating expenses	3(c)	**(3,658)**	(3,272)
Profit from operations	2	**4,655**	4,557
Analysed as:			
- adjusted profit from operations	2	**5,480**	4,992
- restructuring and integration costs	3(d)	**(603)**	(367)
- amortisation and impairment of trademarks and similar intangibles	3(e)	**(149)**	(65)
- Fox River	3(f)	**(20)**	—
- South Korea sales tax	3(g)	**(53)**	—
- Flintkote		**—**	(3)
		4,655	4,557
Net finance (costs)/income	4	**(637)**	62
Finance income		**44**	646
Finance costs		**(681)**	(584)
Share of post-tax results of associates and joint ventures	5	**2,227**	1,236
Analysed as:			
- adjusted share of post-tax results of associates and joint ventures	2	**1,327**	943
- issue of shares and change in shareholding	5	**11**	22
- gain on disposal of assets	5	**941**	371
- other	5	**(52)**	(100)
		2,227	1,236
Profit before taxation		**6,245**	5,855
Taxation on ordinary activities	6	**(1,406)**	(1,333)
Profit for the year		**4,839**	4,522
Attributable to:			
Owners of the parent		**4,648**	4,290
Non-controlling interests		**191**	232
		4,839	4,522
Earnings per share			
Basic	7	**250.2p**	230.9p
Diluted	7	**249.2p**	230.3p

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	2016	2015
		£m	£m
Profit for the year (page 88)		**4,839**	4,522
Other comprehensive income			
Items that may be reclassified subsequently to profit or loss:		**1,760**	(849)
Differences on exchange			
- subsidiaries		**1,270**	(1,006)
- associates		**1,425**	336
Cash flow hedges			
- net fair value gains/(losses)		**29**	(99)
- reclassified and reported in profit for the year		**38**	15
- reclassified and reported in net assets		**(12)**	(45)
Available-for-sale investments			
- net fair value gains in respect of subsidiaries		**—**	14
- reclassified and reported in profit for the year		**—**	(10)
- net fair value (losses)/gains in respect of associates net of tax		**(10)**	1
Net investment hedges			
- net fair value losses		**(837)**	(118)
- differences on exchange on borrowings		**(124)**	42
Tax on items that may be reclassified	6(f)	**(19)**	21
Items that will not be reclassified subsequently to profit or loss:		**(173)**	263
Retirement benefit schemes			
- net actuarial (losses)/gains in respect of subsidiaries	12	**(228)**	283
- surplus recognition and minimum funding obligations in respect of subsidiaries	12	**(1)**	—
- actuarial gains in respect of associates net of tax	5	**20**	3
Tax on items that will not be reclassified	6(f)	**36**	(23)
Total other comprehensive income for the year, net of tax		**1,587**	(586)
Total comprehensive income for the year, net of tax		**6,426**	3,936
Attributable to:			
Owners of the parent		**6,180**	3,757
Non-controlling interests		**246**	179
		6,426	3,936

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						
		Share capital	Share premium, capital redemption and merger reserves	Other reserves	Retained earnings	Total attributable to owners of parent	Non-controlling interests	Total equity
		£m	£m	£m	£m	£m	£m	£m
Balance at 1 January 2016		**507**	**3,927**	**(1,294)**	**1,754**	**4,894**	**138**	**5,032**
Total comprehensive income for the year (page 89)		**—**	**—**	**1,707**	**4,473**	**6,180**	**246**	**6,426**
Profit for the year		**—**	**—**	**—**	**4,648**	**4,648**	**191**	**4,839**
Other comprehensive income for the year		**—**	**—**	**1,707**	**(175)**	**1,532**	**55**	**1,587**
Employee share options								
- value of employee services	25	**—**	**—**	**—**	**71**	**71**	**—**	**71**
- proceeds from shares issued		**—**	**4**	**—**	**—**	**4**	**—**	**4**
Dividends and other appropriations								
- ordinary shares	8	**—**	**—**	**—**	**(2,910)**	**(2,910)**	**—**	**(2,910)**
- to non-controlling interests		**—**	**—**	**—**	**—**	**—**	**(156)**	**(156)**
Purchase of own shares								
- held in employee share ownership trusts		**—**	**—**	**—**	**(64)**	**(64)**	**—**	**(64)**
Non-controlling interests — acquisitions	24(d)	**—**	**—**	**—**	**4**	**4**	**(4)**	**—**
Other movements		**—**	**—**	**—**	**3**	**3**	**—**	**3**
Balance at 31 December 2016		**507**	**3,931**	**413**	**3,331**	**8,182**	**224**	**8,406**

	Notes	Attributable to owners of the parent						
		Share capital	Share premium, capital redemption and merger reserves	Other reserves	Retained earnings	Total attributable to owners of parent	Non-controlling interests	Total equity
		£m	£m	£m	£m	£m	£m	£m
Balance at 1 January 2015		507	3,923	(498)	1,578	5,510	304	5,814
Total comprehensive income for the year (page 89)		—	—	(796)	4,553	3,757	179	3,936
Profit for the year		—	—	—	4,290	4,290	232	4,522
Other comprehensive income for the year		—	—	(796)	263	(533)	(53)	(586)
Employee share options								
- value of employee services	25	—	—	—	50	50	—	50
- proceeds from shares issued		—	4	—	—	4	—	4
Dividends and other appropriations								
- ordinary shares	8	—	—	—	(2,770)	(2,770)	—	(2,770)
- to non-controlling interests		—	—	—	—	—	(238)	(238)
Purchase of own shares								
- held in employee share ownership trusts		—	—	—	(46)	(46)	—	(46)
Non-controlling interests — acquisitions	24(d)	—	—	—	(1,642)	(1,642)	(107)	(1,749)
Other movements		—	—	—	31	31	—	31
Balance at 31 December 2015		507	3,927	(1,294)	1,754	4,894	138	5,032

The accompanying notes are an integral part of the Group financial statements.

Group Balance Sheet
At 31 December

	Notes	2016	2015
		£m	£m
Assets			
Intangible assets	9	**12,117**	10,436
Property, plant and equipment	10	**3,661**	3,021
Investments in associates and joint ventures	11	**9,507**	6,938
Retirement benefit assets	12	**455**	408
Deferred tax assets	13	**436**	326
Trade and other receivables	14	**599**	248
Available-for-sale investments	15	**43**	37
Derivative financial instruments	16	**596**	287
Total non-current assets		**27,414**	21,701
Inventories	17	**5,793**	4,247
Income tax receivable		**69**	74
Trade and other receivables	14	**3,884**	3,266
Available-for-sale investments	15	**15**	35
Derivative financial instruments	16	**375**	209
Cash and cash equivalents	18	**2,204**	1,963
		12,340	9,794
Assets classified as held-for-sale		**19**	20
Total current assets		**12,359**	9,814
Total assets		**39,773**	31,515
Equity — Capital and reserves			
Share capital		**507**	507
Share premium, capital redemption and merger reserves		**3,931**	3,927
Other reserves		**413**	(1,294)
Retained earnings		**3,331**	1,754
Owners of the parent		**8,182**	4,894
Non-controlling interests		**224**	138
Total equity	19	**8,406**	5,032
Liabilities			
Borrowings	20	**16,488**	14,806
Retirement benefit liabilities	12	**826**	653
Deferred tax liabilities	13	**652**	563
Other provisions for liabilities and charges	21	**386**	296
Trade and other payables	22	**1,040**	1,029
Derivative financial instruments	16	**119**	130
Total non-current liabilities		**19,511**	17,477
Borrowings	20	**3,007**	2,195
Income tax payable		**558**	414
Other provisions for liabilities and charges	21	**407**	273
Trade and other payables	22	**7,335**	5,937
Derivative financial instruments	16	**549**	187
Total current liabilities		**11,856**	9,006
Total equity and liabilities		**39,773**	31,515

The accompanying notes are an integral part of the Group financial statements.

On behalf of the Board

Richard Burrows
Chairman

22 February 2017

Group Cash Flow Statement
For the year ended 31 December

	Notes	2016 £m	2015 £m
Profit from operations (page 88)		**4,655**	4,557
Adjustments for			
- depreciation, amortisation and impairment costs		**607**	428
- increase in inventories		**(638)**	(520)
- decrease/(increase) in trade and other receivables		**87**	(508)
- increase in amounts recoverable in respect of Quebec class action	14	**(242)**	(55)
- increase in trade and other payables		**428**	732
- FII GLO receipts	6	**—**	963
- decrease in net retirement benefit liabilities		**(145)**	(191)
- increase in provisions for liabilities and charges		**141**	48
- other non-cash items		**—**	(54)
Cash generated from operations		**4,893**	5,400
Dividends received from associates		**962**	593
Tax paid		**(1,245)**	(1,273)
Net cash generated from operating activities		**4,610**	4,720
Cash flows from investing activities			
Interest received		**62**	64
Purchases of property, plant and equipment		**(586)**	(483)
Proceeds on disposal of property, plant and equipment		**93**	108
Purchases of intangibles		**(88)**	(118)
Purchases of investments		**(109)**	(99)
Proceeds on disposals of investments		**22**	45
Investment in associates and acquisitions of subsidiaries		**(57)**	(3,508)
Proceeds from associates' share buy-backs	11	**23**	—
Net cash used in investing activities		**(640)**	(3,991)
Cash flows from financing activities			
Interest paid		**(641)**	(596)
Proceeds from increases in and new borrowings		**3,476**	6,931
(Outflows)/inflows relating to derivative financial instruments		**(26)**	201
Purchases of own shares held in employee share ownership trusts		**(64)**	(46)
Reductions in and repayments of borrowings		**(3,840)**	(2,028)
Dividends paid to owners of the parent	8	**(2,910)**	(2,770)
Purchases of non-controlling interests		**(70)**	(1,677)
Dividends paid to non-controlling interests		**(147)**	(235)
Other		**(7)**	1
Net cash used in financing activities		**(4,229)**	(219)
Net cash flows (used in)/generated from operating, investing and financing activities		**(259)**	510
Differences on exchange		**180**	(272)
(Decrease)/Increase in net cash and cash equivalents in the year		**(79)**	238
Net cash and cash equivalents at 1 January		**1,730**	1,492
Net cash and cash equivalents at 31 December	18	**1,651**	1,730

The accompanying notes are an integral part of the Group financial statements.

The net cash outflows relating to adjusting items, including £nil (2015: £97 million) of interest are £711 million (2015: £577 million).

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 Group financial statements are prepared on a going concern basis, as set out in the Financial Review on page 35.

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

The preparation of the Group 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 budgeted cash flows of these 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 judgements made in conjunction with independent actuaries. These involve estimates about uncertain future events based on the environment in different countries, including life expectancy of scheme members, salary and pension increases, inflation, 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. The recognised deferred tax assets and liabilities, together with a note of unrecognised amounts, are shown in note 13, and a contingent tax asset is explained in note 6(b). Other provisions for liabilities and charges are as set out in note 21. 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 28. The application of these accounting policies to the payments made and credits recognised under the Master Settlement Agreement by Reynolds American Inc. (Reynolds American) is described in note 5;
- the definition of adjusting items, which are separately disclosed as memorandum information, is explained below and the impact of these on the calculation of adjusted earnings is described in note 7;
- the estimation of the fair values of acquired net assets arising in a business combination and the allocation of the purchase consideration between the underlying net assets acquired, including intangible assets other than goodwill, on the basis of their fair values. These estimates are prepared in conjunction with the advice of independent valuation experts where appropriate. The relevant transactions for 2016 and 2015 are described in note 24 and in note 11;
- the determination as to whether control (subsidiaries), joint control (joint arrangements), or significant influence (associates) exists in relation to the investments held by the Group. This is assessed after taking into account the Group's ability to appoint directors to the entity's board, its relative shareholding compared with other shareholders, any significant contracts or arrangements with the entity or its other shareholders and other relevant facts and circumstances. The application of this judgement in respect of the Group's investment in Reynolds American is explained in note 11; and
- the review of applicable exchange rates for transactions with and translation of entities in territories where there are restrictions on the free access to foreign currency, or multiple exchange rates.

Such estimates and assumptions are based on historical experience and various other factors that are believed to be reasonable in the circumstances and constitute management's best judgement at the date of the

financial statements. In the future, actual experience may deviate from these estimates and assumptions, which could affect the financial statements as the original estimates and assumptions are modified, as appropriate, in the year in which the circumstances change.

Basis of consolidation

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

A subsidiary is an entity controlled by the Group. The Group controls an entity when the Group is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity.

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

Joint arrangements comprise contractual arrangements where two or more parties have joint control and where decisions regarding the relevant activities of the entity require unanimous consent. Joint operations are jointly-controlled arrangements where the parties to the arrangement have rights to the underlying assets and obligations for the underlying liabilities relating to the arrangement. The Group accounts for its share of the assets, liabilities, income and expenses of any such arrangement. Joint ventures comprise arrangements where the parties to the arrangement have rights to the net assets of the arrangement. They are accounted for using the equity method.

Foreign currencies

The functional currency of the Parent Company is sterling and this is also the presentation currency of the Group. The income and cash flow statements of Group undertakings expressed in currencies other than sterling are translated to sterling using exchange rates applicable to the dates of the underlying transactions. Average rates of exchange in each year are used where the average rate approximates the relevant exchange rate at the date of the underlying transactions. Assets and liabilities of Group undertakings are translated at the applicable rates of exchange at the end of each year. In territories where there are restrictions on the free access to foreign currency or multiple exchange rates, the applicable rates of exchange are regularly reviewed.

For hyperinflationary countries, the financial statements in local currency are adjusted to reflect the impact of local inflation prior to translation into sterling.

The differences between retained profits 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, and are presented as a separate component of equity. They are recognised in the income statement when the gain or loss on disposal of a Group undertaking is recognised.

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 intercompany 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 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 including post-retirement healthcare 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.

For defined benefit schemes, the actuarial cost charged to profit from operations consists of current service cost, net interest on the net defined benefit liability or asset, past service cost and the impact of any settlements.

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.

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 substantively enacted at the balance sheet date in the countries where the Group's subsidiaries, associates and joint arrangements operate and generate taxable income.

Deferred taxation is provided in full using the liability method for temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and the amount used for taxation purposes. 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.

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 any impairment of goodwill is recognised immediately in the income statement and is not subsequently reversed.

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

Intangible assets other than goodwill

The intangible assets shown on the Group balance sheet consist mainly of trademarks and similar intangibles, including certain intellectual property, acquired by the Group's subsidiary undertakings and computer software.

Acquired trademarks and similar assets are carried at cost less accumulated amortisation and impairment. Trademarks with indefinite lives are not amortised but are reviewed annually for impairment. Other trademarks and similar assets are amortised on a straight-line basis over their remaining useful lives, consistent with the pattern of economic benefits expected to be received, which do not exceed 20 years. Any impairments of trademarks are recognised in the income statement but increases in trademark values are not recognised.

Computer software is carried at cost less accumulated amortisation and impairment, and, with the exception of global software solutions, is amortised on a straight-line basis over periods ranging from three years to five years. Global software solutions are software assets designed to be implemented on a global basis and used as a standard solution by all of the operating companies in the Group. These assets are amortised on a straight-line basis over periods not exceeding ten years.

The investments in associates and joint ventures shown in the Group balance sheet include trademarks arising from the combination of Brown & Williamson (B&W) and R J Reynolds (RJR) in 2004 to form Reynolds American Inc. (Reynolds American), as well as those arising on the acquisition by Reynolds American of Conwood 2006 and Lorillard in 2015. Most of the carrying value of these assets relates to intangibles which are deemed to have indefinite lives and each trademark is subject to an annual impairment test.

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, are capitalised as part of the cost of the asset.

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.

Impairment of non-financial assets

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

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

Impairment of financial assets

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

Inventories

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

Financial instruments

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

Financial assets and financial liabilities are initially recognised at fair value, plus directly attributable transaction costs where applicable, with subsequent measurement as set out below.

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

Available-for-sale investments:

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

Loans and receivables:

These are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market.

Cash and cash equivalents:

Cash and cash equivalents include cash in hand and deposits held on call, together with other short-term highly liquid investments including investments in certain money market funds. Cash equivalents normally comprise instruments with maturities of three months or less at date of acquisition. In the cash flow statement, cash and cash equivalents are shown net of bank overdrafts, which are included as current borrowings in the liabilities section on the balance sheet.

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. 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 primarily a single product business providing cigarettes and other tobacco products. While the Group has clearly differentiated brands, global segmentation between a wide portfolio of brands is not part of the regular internally reported financial information. The results of Next-Generation Products are not currently material to the Group.

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

Adjusting items

Adjusting items are significant items in the profit from operations, net finance costs, taxation and the Group's share of the post-tax results of associates and joint ventures which individually or, if of a similar type, in aggregate, are relevant to an understanding of the Group's underlying financial performance. While the disclosure of adjusting items is not required by IFRS, these items are separately disclosed either as memorandum information on the face of the income statement and in the segmental analyses, or in the notes to the accounts as appropriate.

The Group believes that these items are useful to users of the Group financial statements in helping them to understand the underlying business performance and are used to derive the Group's principal non-GAAP measures of adjusted profit from operations and adjusted diluted earnings per share.

Provisions

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

Contingent liabilities and contingent assets

Subsidiaries and associate companies are defendants in tobacco-related and other litigation. Provision for this litigation (including legal costs) 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.

Where a provision has not been recognised, the Group records its external legal fees and other external defence costs for tobacco-related and other litigation as these costs are incurred.

Repurchase of share capital

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

Future changes to accounting policies

Certain changes to IFRS will be applicable to the Group financial statements in future years. Set out below are those which are considered to be most relevant to the Group.

IFRS 9 *Financial Instruments*. This standard was finalised and published in July 2014 as the replacement for IAS 39, and the mandatory effective date of implementation is 1 January 2018. The standard is largely retrospective in application. Further due diligence will be carried out before implementation, but the anticipated impact from restatement on the Group's reported profit and equity for 2016 and 2015 is not expected to be material.

IFRS 15 *Revenue from Contracts with Customers*. This standard was published in May 2014 as the replacement to IAS 18, and the mandatory effective date of implementation is 1 January 2018. The standard is retrospective in application. Further due diligence will be carried out before implementation, but the anticipated impact from restatement on the Group's operating profit for 2016 and 2015 is not expected to be material. However, this standard may require changes to the allocation of costs between operating expenses and deductions from revenue including, for example, payments to customers currently classed as expenses.

IFRS 16 *Leases*. This standard was finalised and published in January 2016 and is a major revision to the way that entities will account for leases. The distinction between operating leases and finance leases enshrined in current accounting requirements (IAS 17) is removed with the effect that virtually all leasing arrangements will be brought on to the balance sheet as financial obligations and 'right-to-use' assets. Further due diligence will be carried out before implementation, but the anticipated impact from restatement on the Group's operating profit

and net assets for 2016 and 2015 is not expected to be material, although assets and liabilities would have been grossed up by approximately £180 million in 2016 and £200 million in 2015 based on current leasing commitments as disclosed in note 28. The standard is retrospective in application, but allows for implementation either as a single cumulative amount at the date of initial application or as an adjustment to each prior reporting period. Subject to EU endorsement, the expected mandatory effective date of implementation is 1 January 2019.

Amendment to IAS 7 *Statement of Cash Flows*. This amendment to IAS 7, issued in January 2016, was generated by the IASB's "Disclosure Initiative" project and requires reporting entities to provide disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities, by disclosing changes arising from cash flows as well as non-cash changes. Subject to EU endorsement, the expected mandatory effective date of implementation is 1 January 2017.

In addition, a number of other interpretations and revisions to existing standards have been issued which will be applicable to the Group's financial statements in future years, but will not have a 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 to the overall business. The results of Next Generation Products as a separate segment are currently not material to the Group and therefore it is not considered a reportable segment that requires separate disclosure under the requirements of IFRS 8 *Operating segments*. Interest income, interest expense and taxation are centrally managed and accordingly such items are not presented by segment as they are excluded from the measure of segment profitability.

The four geographic regions are the reportable segments for the Group as they form the focus of the Group's internal reporting systems and are the basis used by the Management Board for assessing performance and allocating resources. The Management Board reviews current and prior year segmental revenue, adjusted profit from operations of subsidiaries and joint operations, and adjusted post-tax results of associates and joint ventures at constant rates of exchange. The constant rate comparison provided for reporting segment information is based on a retranslation, at prior year exchange rates, of the current year results of the Group, including intercompany royalties payable in foreign currency to UK entities. However, the Group does not adjust for the normal transactional gains and losses in operations which are generated by movements in exchange rates. As a result, the 2016 segmental results were translated using the 2015 rates of exchange. The 2015 figures are stated at the 2015 rates of exchange and are, therefore, unadjusted from those published for 2015. The analyses of revenue for the 12 months to 31 December 2016 and 31 December 2015, based on location of sales, are as follows:

	2016			2015
	Revenue Constant rates	Translation exchange	Revenue Current rates	Revenue
	£m	£m	£m	£m
Asia-Pacific	**3,770**	**496**	**4,266**	3,773
Americas	**3,014**	**(146)**	**2,868**	2,720
Western Europe	**3,471**	**396**	**3,867**	3,203
EEMEA	**3,753**	**(3)**	**3,750**	3,408
Revenue	**14,008**	**743**	**14,751**	13,104

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:

	2016					2015		
	Adjusted* segment result Constant rates	Translation exchange	Adjusted* segment result Current rates	Adjusting items	Segment result Current rates	Adjusted* segment result	Adjusting items	Segment result
	£m	£m	£m	£m	£m	£m	£m	£m
Asia-Pacific	**1,488**	**142**	**1,630**	**(198)**	**1,432**	1,469	(108)	1,361
Americas	**1,202**	**(30)**	**1,172**	**(155)**	**1,017**	1,169	(87)	1,082
Western Europe	**1,236**	**153**	**1,389**	**(345)**	**1,044**	1,146	(156)	990
EEMEA	**1,271**	**18**	**1,289**	**(107)**	**1,182**	1,208	(81)	1,127
	5,197	**283**	**5,480**	**(805)**	**4,675**	4,992	(432)	4,560
Fox River**				**(20)**	**(20)**		—	—
Flintkote**				**—**	**—**		(3)	(3)
Profit from operations	**5,197**	**283**	**5,480**	**(825)**	**4,655**	4,992	(435)	4,557
Net finance (costs)/income	**(494)**	**(35)**	**(529)**	**(108)**	**(637)**	(427)	489	62
Asia-Pacific	**307**	**24**	**331**	**11**	**342**	286	16	302
Americas	**877**	**114**	**991**	**889**	**1,880**	656	277	933
Western Europe	**4**	**(1)**	**3**	**—**	**3**	—	—	—
EEMEA	**2**	**—**	**2**	**—**	**2**	1	—	1
Share of post-tax results of associates and joint ventures	**1,190**	**137**	**1,327**	**900**	**2,227**	943	293	1,236
Profit before taxation	**5,893**	**385**	**6,278**	**(33)**	**6,245**	5,508	347	5,855

* The adjustments to profit from operations, net finance (costs)/income and the Group's share of the post-tax results of associates and joint ventures are explained in notes 3(d) to 3(g), note 4(b) and note 5, respectively.

** The Fox River charge in 2016 (see note 3(f) and note 28) and the Flintkote charge in 2015 have not been allocated to any segment as they neither relate to current operations nor the tobacco business. They are presented separately from the segmental reporting which is used to evaluate segment performance and to allocate resources, and is reported to the chief operating decision maker on this basis.

Adjusted profit from operations at constant rates of £5,197 million (2015: £4,992 million) excludes certain depreciation, amortisation and impairment charges as explained in notes 3(d) and 3(e). These are excluded from segmental profit from operations at constant rates as follows:

	2016					2015		
	Adjusted depreciation, amortisation and impairment Constant rates	Translation exchange	Adjusted depreciation, amortisation and impairment Current rates	Adjusting items	Depreciation, amortisation and impairment Current rates	Adjusted depreciation, amortisation and impairment	Adjusting items	Depreciation, amortisation and impairment
	£m	£m	£m	£m	£m	£m	£m	£m
Asia-Pacific	**96**	**9**	**105**	**51**	**156**	95	33	128
Americas	**83**	**3**	**86**	**44**	**130**	84	9	93
Western Europe	**100**	**9**	**109**	**103**	**212**	75	39	114
EEMEA	**96**	**(1)**	**95**	**14**	**109**	83	10	93
	375	**20**	**395**	**212**	**607**	337	91	428

External revenue and non-current assets other than financial instruments, deferred tax assets and retirement benefit assets are analysed between the UK and all foreign countries at current rates of exchange as follows:

	United Kingdom		All foreign countries		Group	
	2016	2015	2016	2015	2016	2015
	£m	£m	£m	£m	£m	£m
Revenue is based on location of sale						
External revenue	**272**	190	**14,479**	12,914	**14,751**	13,104

	United Kingdom		All foreign countries		Group	
	2016	2015	2016	2015	2016	2015
	£m	£m	£m	£m	£m	£m
Intangible assets	**551**	580	**11,566**	9,856	**12,117**	10,436
Property, plant and equipment	**371**	378	**3,290**	2,643	**3,661**	3,021
Investments in associates and joint ventures	**—**	—	**9,507**	6,938	**9,507**	6,938

In 2016, there is no foreign operation that requires separate disclosure under the requirements of IFRS 8 *Operating Segments*.

The main acquisitions comprising the goodwill balance of £11,023 million (2015: £9,324 million), included in intangible assets, are provided in note 9. Included in investments in associates and joint ventures are amounts of £8,051 million (2015: £5,749 million) attributable to the investment in Reynolds American and £1,394 million (2015: £1,136 million) attributable to the investment in ITC Ltd. Further information is provided in note 11.

3 Profit from operations

(a) Employee benefit costs

	2016	2015
	£m	£m
Wages and salaries	**1,882**	1,667
Social security costs	**207**	174
Other pension and retirement benefit costs (note 12)	**101**	138
Share-based payments — equity and cash-settled (note 25)	**84**	60
	2,274	2,039

(b) Depreciation, amortisation and impairment costs

		2016	2015
		£m	£m
Intangibles	- amortisation and impairment of trademarks and similar intangibles (note 3(e))	**149**	65
	- amortisation and impairment of other intangibles	**81**	89
Property, plant and equipment	- depreciation and impairment	**377**	274
		607	428

(c) Other operating expenses include:

	2016	2015
	£m	£m
Research and development expenses (excluding employee benefit costs and depreciation)	**53**	60
Exchange differences	**(2)**	10
Rent of plant and equipment (operating leases)		
- minimum lease payments	**20**	20
Rent of property (operating leases)		
- minimum lease payments	**51**	52
Fees payable for audit services pursuant to legislation:		
- fees payable to KPMG LLP for Parent Company and Group audit	**2.0**	2.0
- fees payable to other KPMG LLP firms and associates for local statutory and Group reporting audits	**7.2**	6.7
Audit fees payable to KPMG LLP firms and associates	**9.2**	8.7
Audit fees payable to other firms	**—**	0.6
Total audit fees payable	**9.2**	9.3
Fees payable to KPMG LLP firms and associates for other services:		
- audit-related assurance services	**0.2**	0.2
- other assurance services	**0.1**	0.1
- tax advisory services	**0.2**	0.6
- tax compliance	**0.3**	0.4
- other non-audit services	**1.4**	2.0
	2.2	3.3

The total fees payable to KPMG firms and associates included above are £11.4 million (2015: £12.0 million).

Total research and development costs including employee benefit costs and depreciation are £144 million (2015: £148 million).

(d) Restructuring and integration costs

Restructuring costs reflect the costs incurred as a result of initiatives to improve the effectiveness and the efficiency of the Group as a globally integrated enterprise, including the relevant operating costs of implementing the new operating model. These costs represent additional expenses incurred, which are not related to the normal business and day-to-day activities.

The new operating model as reported in the Group's 2015 Annual Report and Accounts is underpinned by a global single instance of SAP with full deployment occurring during 2016 with benefits already realised within the business and future savings expected in the years to come. The initiatives also include a review of the Group's manufacturing operations, supply chain, overheads and indirect costs, organisational structure and systems and software used.

The costs of these initiatives together with the costs of integrating acquired businesses into existing operations, including acquisition costs, are included in profit from operations under the following headings:

	2016	2015
	£m	£m
Employee benefit costs	**240**	159
Depreciation, amortisation and impairment costs	**64**	26
Other operating expenses	**325**	228
Other operating income	**(26)**	(46)
	603	367

Restructuring and integration costs in 2016 principally relate to the restructuring initiatives directly related to implementation of a new operating model and the cost of initiatives in respect of permanent headcount reductions and permanent employee benefit reductions in the Group. The costs also cover factory closure and downsizing activities in Germany, Malaysia and Brazil, certain exit costs and asset write-offs related to the change in approach to the commercialisation of Voke (as announced on 5 January 2017), uncertainties surrounding regulatory changes and restructurings in Japan and Australia.

Restructuring and integration costs in 2015 principally related to the restructuring initiatives directly related to implementation of a new operating model and the cost of initiatives in respect of permanent headcount reductions and permanent employee benefit reductions in the Group. The costs also cover factory closure and downsizing activities in Australia, certain costs related to the acquisitions undertaken (including TDR in Croatia) and restructurings in Indonesia, Canada, Switzerland and Germany.

Other operating income in 2016 includes gains from the sale of land and buildings in Malaysia. In 2015, other operating income includes gains from the sale of land and buildings in Australia.

(e) Amortisation and impairment of trademarks and similar intangibles

Acquisitions including Ten Motives (see note 24), CHIC, TDR, Bentoel, Tekel and ST resulted in the capitalisation of trademarks and similar intangibles which are amortised over their expected useful lives, which do not exceed 20 years. The amortisation and impairment charge of £149 million (2015: £65 million) is included in depreciation, amortisation and impairment costs in profit from operations.

(f) Fox River

As explained in note 28, a Group subsidiary has certain liabilities in respect of indemnities given on the purchase and disposal of former businesses in the United States and in 2011, the subsidiary provided £274 million in respect of claims in relation to environmental clean-up costs of the Fox River.

On 30 September 2014, a Group subsidiary, NCR, Appvion and Windward Prospects entered into a Funding Agreement with regard to the costs for the clean-up of Fox River. Based on this Funding Agreement, £17 million has been paid in 2016, which includes legal costs of £11 million (2015: £17 million, including legal costs of £8 million).

In 2016, NCR and Appvion entered into a settlement agreement with certain other defendants (the "Settling 5") to release claims amongst those parties. In January 2017, NCR and Appvion also entered into a consent decree with the US Government to resolve how the remaining clean-up will be funded and to resolve further outstanding claims between them, although this consent decree requires approval from the District Court of Wisconsin. The agreements reduce the Group's exposure under the Funding Agreement. However, this is offset by the devaluation of Sterling against the US Dollar, leading to a net charge of £20 million (2015: nil). Considering these developments, the provision is £163 million at 31 December 2016 (up £3 million against prior year).

On 10 February 2017, a decision was delivered on the further hearing related to a payment of dividends by Windward to Sequana in May 2009. Further details are provided in note 28.

(g) South Korea sales tax

In 2016, the Board of Audit and Inspection of Korea ("BAI") concluded its tax assessment in relation to the 2014 year-end tobacco inventory, and imposed additional sales tax (excise and VAT) and penalties. This resulted in the recognition of a £53 million charge by a Group subsidiary. Management deems the tax and penalties to be unfounded and has appealed to the tax tribunal against the assessment. Based on the legal opinion from a local law firm, management believes that this appeal will be successful, and that the findings of the BAI will be reversed.

On grounds of materiality and the high likelihood of the tax and penalties being reversed in future, the Group has classified the tax and penalties charge as an adjusting item in 2016.

4 Net finance costs/(income)

(a) Net finance costs/(income)

	2016	2015
	£m	£m
Interest payable	**645**	573
Option costs and fees (see note 4(b)(iv))	**—**	104
Facility fees	**5**	9
Interest related to FII GLO (see note 4(b)(i))	**25**	8
Loss on bond redemption (see note 4(b)(ii))	**101**	—
Fair value changes on derivative financial instruments and hedged items	**(458)**	(245)
Exchange differences on financial liabilities	**363**	135
Finance costs	**681**	**584**
Interest and dividend income	**(68)**	(79)
Hedge ineffectiveness (see note 4(b)(iii))	**(18)**	—
Deemed gain related to the investment in Reynolds American (see note 4(b)(v))	**—**	(601)
Exchange differences on financial assets	**42**	34
Finance income	**(44)**	**(646)**
Net finance costs/(income)	**637**	**(62)**

The Group manages foreign exchange gains and losses and fair value changes on a net basis excluding adjusting items, which are explained in note 4(b) and the derivatives that generate the fair value changes are as in note 16.

Facility fees principally relate to the Group's central undrawn banking facilities of £3 billion and US$150 million (2015: £3 billion and US$150 million).

(b) Adjusting items included in net finance costs/(income)

Adjusting items are significant items in net finance costs/(income) which individually or, if of a similar type, in aggregate, are relevant to an understanding of the Group's underlying financial performance.

In 2016, the following adjusting items have been recognised:

(i) as described in note 6, in 2015, the Group received £963 million from HM Revenue & Customs in relation to the Franked Investment Income Group Litigation Order (FII GLO). Interest of £25 million (2015: £8 million) has been accrued and treated as an adjusting item;

(ii) the Group redeemed a US$700 million bond, prior to its original maturity date of 15 November 2018. This led to a loss of US$130 million (£101 million), which has been treated as an adjusting item; and

(iii) the Group experienced significant hedge ineffectiveness, driven by the market volatility in the first six months of the year. The gain of £18 million has been deemed to be adjusting, as it is not representative of the underlying performance of the business through the twelve months to 31 December 2016.

In 2015, the following adjusting items have been recognised:

(iv) costs of £104 million in relation to financing activities, which includes costs on the acquisition of the non-controlling interests in the Group's Brazilian subsidiary, Souza Cruz S.A. and the Group's activities to maintain the current ownership in Reynolds American following its acquisition of Lorillard, Inc.; and

(v) the Group's investment of US$4.7 billion in cash in Reynolds American has realised a deemed gain of US$931 million (£601 million). The deemed gain reflects the difference between the fixed price paid by the Group to Reynolds American and the market value of Reynolds American shares on the day of the transaction (see note 11).

5 Associates and joint ventures

	2016		2015	
	Total	Group's share	Total	Group's share
	£m	£m	£m	£m
Revenue	**16,491**	**5,997**	11,186	4,215
Profit from operations	**9,379**	**3,740**	6,117	2,391
Net finance costs	**(477)**	**(200)**	(335)	(139)
Profit on ordinary activities before taxation	**8,902**	**3,540**	5,782	2,252
Taxation on ordinary activities	**(3,280)**	**(1,308)**	(2,545)	(1,013)
Profit on ordinary activities after taxation	**5,622**	**2,232**	3,237	1,239
Non-controlling interests	**(17)**	**(5)**	(12)	(3)
Post-tax results of associates and joint ventures	**5,605**	**2,227**	3,225	1,236
Analysed as:				
- adjusted share of post-tax results of associates and joint ventures	**3,461**	**1,327**	2,501	943
- issue of shares and change in shareholding	**36**	**11**	74	22
- gain on disposal of assets	**2,231**	**941**	879	371
- other	**(123)**	**(52)**	(229)	(100)
	5,605	**2,227**	3,225	1,236

(a) Adjusting items

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 2016, the Group's interest in ITC Ltd. ("ITC") decreased from 30.06% to 29.89% (2015: 30.26% to 30.06%) as a result of ITC issuing ordinary shares under the company's Employee Share Option Scheme. The issue of these shares and change in the Group's share of ITC resulted in a gain of £11 million (2015: gain of £22 million), which is treated as a deemed partial disposal and included in the income statement.

In 2016, Reynolds American recognised a gain in relation to the sale of the international rights to Natural American Spirit to the Japan Tobacco Group of companies (JT) of US$4,861 million. The Group's share of this net gain amounted to £941 million (net of tax). In 2015, Reynolds American recognised a gain on the related divestiture of assets, following the Lorillard, Inc. ("Lorillard") acquisition, of US$3,288 million. The Group's share of this net gain amounted to £371 million (net of tax).

Reynolds American has also recognised amounts that have been combined in the table of adjusting items in the Group's income statement and are included within "other". In 2016, this includes income relating to the early termination of the Manufacturing Agreement between BATUS Japan Inc. and R.J. Reynolds Tobacco Company (see note 27) of US$90 million, the Group's share of which is £18 million (net of tax), restructuring charges of US$36 million, the Group's share of which is £7 million (net of tax) (2015: US$223 million, the Group's share of which is £39 million (net of tax)) and costs in respect of a number of Engle progeny lawsuits and other tobacco

litigation charges that amounted to US$86 million, the Group's share of which is £17 million (net of tax) (2015: US$152 million, the Group's share of which is £26 million (net of tax)). Additionally, there is income of US$6 million (2015: US$108 million) related to the Non-Participating Manufacturer (NPM) Adjustment claims of the states no longer challenging the findings of non-diligence entered against them by an Arbitration Panel, the Group's share of which is £2 million (2015: £18 million) (net of tax). Also included in 2016 are transaction costs of US$5 million (2015: US$54 million) and financing costs of US$243 million (2015: US$60 million), connected with the acquisition of Lorillard, the Group's share (net of tax) of which is £1 million and £47 million (2015: £12 million and £10 million), respectively. The remaining costs in 2015 of US$99 million are primarily in respect of asset impairment and exit charges, the Group's share of which is £25 million (net of tax).

(b) Master Settlement Agreement

In 1998, the major US cigarette manufacturers (including R J Reynolds, Lorillard and Brown & Williamson, businesses which are now part of Reynolds American) entered into the Master Settlement Agreement (MSA) with attorney generals representing most US states and territories. The MSA imposes a perpetual stream of future payment obligations on the major US cigarette manufacturers. The amounts of money that the participating manufacturers are required to annually contribute are based upon, amongst other things, the volume of cigarettes sold and market share (based on cigarette shipments in that year). Given these facts, the Group's accounting for the MSA payments is to accrue for them in the cost of products sold as the products are shipped and no provision is made in respect of potential payments relating to future years. The event which gives rise to the obligation is the actual sales of products shipped and the MSA payments are therefore recognised as part of the costs of those business operations.

During 2013, Reynolds American, various other tobacco manufacturers, 19 states, the District of Columbia and Puerto Rico reached a final agreement related to Reynolds American's 2003 Master Settlement Agreement (MSA) activities. Under this agreement Reynolds American will receive credits, currently estimated to be more than US$1 billion, in respect of its Non-Participating Manufacturer (NPM) Adjustment claims related to the period from 2003 to 2012. These credits will be applied against the company's MSA payments over a period of five years from 2013, subject to, and dependent upon, meeting the various ongoing performance obligations.

During 2014, two additional states agreed to settle NPM disputes related to claims for the period 2003 to 2012. It is estimated that Reynolds American will receive US$170 million in credits, which will be applied over a five-year period from 2014.

During 2015, another state agreed to settle NPM disputes related to claims for the period 2004 to 2014. It is estimated that Reynolds American will receive US$285 million in credits, which will be applied over a four-year period from 2015.

During 2016, there were no settlements paid or any new states agreeing to settle NPM disputes.

Credits in respect of future years' payments and the NPM Adjustment claims would be accounted for in the applicable year and will not be treated as adjusting items. Only credits in respect of prior year payments are included as adjusting items.

(c) Other financial information

	2016	2015
	Group's share	Group's share
	£m	£m
Profit on ordinary activities after taxation		
- attributable to owners of the Parent	**2,227**	1,236
Other comprehensive income:		
Differences on exchange	**1,425**	336
Net fair value (losses)/gains on available-for-sale investments	**(10)**	1
Actuarial gains relating to pensions and other post-retirement benefits (note 19)	**20**	3
Total comprehensive income (note 11)	**3,662**	1,576

Summarised financial information of the Group's associates and joint ventures:

	2016				2015			
	Reynolds American	ITC	Others	Total	Reynolds American	ITC	Others	Total
	£m	£m	£m	£m	£m	£m	£m	£m
Revenue	**9,224**	**5,350**	**1,917**	**16,491**	6,986	3,839	361	11,186
Profit on ordinary activities before taxation	**7,111**	**1,743**	**48**	**8,902**	4,250	1,505	27	5,782
Post-tax results of associates and joint ventures	**4,457**	**1,114**	**34**	**5,605**	2,203	1,005	17	3,225
Other comprehensive income	**3,125**	**712**	**(178)**	**3,659**	684	43	(24)	703
Total comprehensive income	**7,582**	**1,826**	**(144)**	**9,264**	2,887	1,048	(7)	3,928

6 Taxation on ordinary activities

(a) Summary of taxation on ordinary activities

	2016	2015
	£m	£m
UK corporation tax	**7**	5
Overseas tax	**1,395**	1,324
Comprising:		
- current year tax expense	**1,382**	1,317
- adjustments in respect of prior periods	**13**	7
Total current tax	**1,402**	1,329
Deferred tax	**4**	4
Comprising:		
- deferred tax relating to origination and reversal of temporary differences	**4**	(11)
- deferred tax relating to changes in tax rates	**—**	15
	1,406	1,333

(b) Franked Investment Income Group Litigation Order

The Group is the principal test claimant in an action in the United Kingdom against HM Revenue and Customs (HMRC) in the Franked Investment Income Group Litigation Order (FII GLO). There are 25 corporate groups in the FII GLO. The case concerns the treatment for UK corporate tax purposes of profits earned overseas and distributed to the UK.

The original claim was filed in 2003. The trial of the claim was split broadly into issues of liability and quantification. The main liability issues were heard by the High Court, Court of Appeal and Supreme Court in the UK and the European Court of Justice in the period to November 2012. The detailed technical issues of the quantification mechanics of the claim were heard by the High Court during May and June 2014 and the judgment handed down on 18 December 2014. The High Court determined that in respect of issues concerning the calculation of unlawfully charged corporation tax and advance corporation tax, the law of restitution including the defence on change of position and questions concerning the calculation of overpaid interest, the approach of the Group was broadly preferred. The conclusion reached by the High Court would, if upheld, produce an estimated receivable of £1.2 billion for the Group. Appeals on a majority of the issues were made to the Court of Appeal, which heard the arguments in June 2016. The Court of Appeal determined in November 2016 on the majority of issues that the conclusion reached by the High Court should be upheld. The outcome of the Court of Appeal has not reduced the estimated receivable. Permission has been sought by HMRC to appeal almost all issues on which it was unsuccessful to the Supreme Court.

During 2015, HMRC paid to the Group a gross amount of £1,224 million in two separate payments. The payments made by HMRC have been made without any admission of liability and are subject to refund were HMRC to succeed on appeal. The second payment in November 2015 followed the introduction of a new 45% tax on the interest component of restitution claims against HMRC. HMRC held back £261 million from the second payment contending that it represents the new 45% tax on that payment, leading to total cash received by

the Group of £963 million. Actions challenging the legality of the 45% tax have been lodged by both the Group and other participants in the FII GLO which will be heard in 2017.

Due to the uncertainty of the amounts and eventual outcome the Group has not recognised any impact in the income statement in the current or prior period. The receipt, net of the deduction by HMRC, is held as deferred income as disclosed in note 22. Any future recognition as income will be treated as an adjusting item, due to the size of the amount, with interest of £25 million for the 12 months to 31 December 2016 (2015: £8 million) accruing on the balance, which was also treated as an adjusting item.

(c) Factors affecting the taxation charge

The taxation charge differs from the standard 20% (2015: 20%) rate of corporation tax in the UK. The major causes of this difference are listed below:

	2016		2015	
	£m	**%**	**£m**	**%**
Profit before tax	**6,245**		5,855	
Less: share of post-tax results of associates and joint ventures	**(2,227)**		(1,236)	
	4,018		4,619	
Tax at 20% (2015: 20%) on the above	**804**	**20.0**	924	20.0
Factors affecting the tax rate:				
Tax at standard rates other than UK corporation tax rate	**93**	**2.3**	231	5.0
Other national tax charges	**74**	**1.9**	77	1.7
Permanent differences	**143**	**3.6**	(147)	(3.2)
Overseas tax on distributions	**41**	**1.0**	28	0.6
Overseas withholding taxes	**200**	**5.0**	145	3.1
Double taxation relief on UK profits	**(8)**	**(0.2)**	(6)	(0.1)
Unutilised tax losses	**32**	**0.8**	32	0.7
Adjustments in respect of prior periods	**13**	**0.3**	7	0.2
Deferred tax relating to changes in tax rates	**—**	**—**	15	0.3
Additional net deferred tax charges	**14**	**0.3**	27	0.6
	1,406	**35.0**	1,333	28.9

In 2016, permanent differences include non-tax deductible expenses for a number of items including expenditure relating to restructuring and integration costs such as factory rationalisation and the implementation of a new operating model, together with the net charge in respect of Fox River, South Korea sales tax assessment and uncertain items connected with the Group's trading business. In 2015, permanent differences includes the deemed gain as explained in note 6(e).

(d) Adjusting items included in taxation

IFRS requires entities to provide deferred taxation on the undistributed earnings of associates and joint ventures. In 2016, the Group's share of the gain on the divestiture of intangibles and other assets by Reynolds American to Japan Tobacco International is £941 million. Given that the profit on this item is recognised as an adjusting item by the Group, the additional deferred tax charge of £61 million on the potential distribution of these undistributed earnings has also been treated as adjusting. In 2015, the Group's share of the gain on the divestiture of intangibles and other assets by Reynolds American to ITG Brands LLC, a subsidiary of Imperial Tobacco Group PLC (now Imperial Brands plc), is £371 million. Given that the profit on this item is recognised as an adjusting item by the Group, the additional deferred tax charge of £22 million on the potential distribution of these undistributed earnings has also been treated as adjusting.

(e) Tax on adjusting items

In addition, the tax on adjusting items, separated between the different categories, as per note 7, amounted to £128 million (2015: £80 million). As described in note 4(b), in 2015, the Group's investment of US$4.7 billion in cash in Reynolds American has realised a deemed gain of US$931 million (£601 million). The adjustment to the adjusted earnings per share (see note 7) also includes £1 million (2015: £3 million) in respect of the non-controlling interests' share of the adjusting items net of tax.

(f) Tax on items recognised directly in other comprehensive income

	2016	2015
	£m	£m
Current tax	**(53)**	7
Deferred tax	**70**	(9)
Credited/(charged) to other comprehensive income	**17**	(2)

The tax relating to each component of other comprehensive income is disclosed in note 19.

7 Earnings per share

	2016			2015		
	Earnings	Weighted average number of shares	Earnings per share	Earnings	Weighted average number of shares	Earnings per share
	£m	m	pence	£m	m	pence
Basic earnings per share (ordinary shares of 25p each)	**4,648**	**1,858**	**250.2**	4,290	1,858	230.9
Share options	**—**	**7**	**(1.0)**	—	5	(0.6)
Diluted earnings per share	**4,648**	**1,865**	**249.2**	4,290	1,863	230.3

Earnings have been affected by a number of adjusting items, which are described in notes 3 to 6. To illustrate the impact of these items, an adjusted earnings per share calculation is shown below.

Adjusted earnings per share calculation

		Diluted				Basic			
		2016		2015		2016		2015	
	Notes	Earnings	Earnings per share	Earnings	Earnings per share	Earnings	Earnings per share	Earnings	Earnings per share
		£m	pence	£m	pence	£m	pence	£m	pence
Unadjusted earnings per share		**4,648**	**249.2**	4,290	230.3	**4,648**	**250.2**	4,290	230.9
Effect of restructuring and integration costs	3(d)	**603**	**32.3**	367	19.7	**603**	**32.4**	367	19.7
Tax and non-controlling interests on restructuring and integration costs		**(90)**	**(4.8)**	(74)	(4.0)	**(90)**	**(4.9)**	(74)	(4.0)
Effect of amortisation and impairment of trademarks and similar intangibles	3(e)	**149**	**8.0**	65	3.5	**149**	**8.0**	65	3.5
Tax on amortisation and impairment of trademarks and similar intangibles		**(32)**	**(1.7)**	(9)	(0.5)	**(32)**	**(1.7)**	(9)	(0.5)
Effect of Fox River	3(f)	**20**	**1.1**	—	—	**20**	**1.1**	—	—
Effect of Flintkote		**—**	**—**	3	0.2	**—**	**—**	3	0.2
South Korean sales tax	3(g)	**53**	**2.9**	—	—	**53**	**2.9**	—	—
Tax effect of South Korean sales tax		**(5)**	**(0.3)**	—	—	**(5)**	**(0.3)**	—	—
Effect of deemed gain related to investment in Reynolds American	4(b)	**—**	**—**	(601)	(32.3)	**—**	**—**	(601)	(32.3)
Effect of additional deferred tax charge from gain on divestiture of assets by associate Reynolds American	6(d)	**61**	**3.3**	22	1.2	**61**	**3.3**	22	1.2
Effect of associates' adjusting items net of tax	5(a)	**(900)**	**(48.3)**	(293)	(15.7)	**(900)**	**(48.4)**	(293)	(15.8)
Effect of interest on FII GLO settlement	4(b)	**25**	**1.3**	8	0.4	**25**	**1.3**	8	0.4
Effect of certain costs and fees related to the acquisition of NCI in Souza Cruz and investment in Reynolds American	4(b)	**—**	**—**	104	5.6	**—**	**—**	104	5.6
Effect of US bond buy back	4(b)	**101**	**5.5**	—	—	**101**	**5.5**	—	—
Effect of hedge ineffectiveness	4(b)	**(18)**	**(1.0)**	—	—	**(18)**	**(1.0)**	—	—
Adjusted earnings per share		**4,615**	**247.5**	3,882	208.4	**4,615**	**248.4**	3,882	208.9

Headline earnings per share as required by the JSE Limited

The presentation of headline earnings per share, as an alternative measure of earnings per share, is mandated under the JSE Listing Requirements. It is calculated in accordance with Circular 2/2016 'Headline Earnings', as issued by the South African Institute of Chartered Accountants. There is no impact of the new circular on the prior year headline earnings per share.

	Diluted				Basic			
	2016		2015		2016		2015	
	Earnings	Earnings per share	Earnings	Earnings per share	Earnings	Earnings per share	Earnings	Earnings per share
	£m	pence	£m	pence	£m	pence	£m	pence
Unadjusted earnings per share	**4,648**	**249.2**	4,290	230.3	**4,648**	**250.2**	4,290	230.9
Effect of impairment of intangibles, property, plant and equipment, and assets held-for-sale	**126**	**6.8**	27	1.4	**126**	**6.8**	27	1.4
Tax and non-controlling interests on impairment of intangibles, and property, plant and equipment	**(35)**	**(1.9)**	(6)	(0.3)	**(35)**	**(1.9)**	(6)	(0.3)
Effect of gains on disposal of property, plant and equipment and held-for-sale assets	**(59)**	**(3.2)**	(60)	(3.2)	**(59)**	**(3.2)**	(60)	(3.2)
Tax and non-controlling interests on disposal of property, plant and equipment and held-for-sale assets	**30**	**1.6**	19	1.0	**30**	**1.6**	19	1.0
Effect of gains reclassified from the available-for-sale reserve	**—**	**—**	(10)	(0.6)	**—**	**—**	(10)	(0.6)
Tax and non-controlling interests on gains reclassified from the available-for-sale reserve	**—**	**—**	3	0.2	**—**	**—**	3	0.2
Share of associates' impairment losses and non-current investments	**—**	**—**	17	0.9	**—**	**—**	17	0.9
Share of associates' gains on disposal of assets	**(941)**	**(50.4)**	(371)	(19.9)	**(941)**	**(50.6)**	(371)	(19.9)
Tax effect of associates' disposal of assets	**61**	**3.3**	22	1.2	**61**	**3.3**	22	1.2
Issue of shares and change in shareholding in associate	**(11)**	**(0.6)**	(22)	(1.2)	**(11)**	**(0.6)**	(22)	(1.2)
Headline earnings per share	**3,819**	**204.8**	3,909	209.8	**3,819**	**205.6**	3,909	210.4

8 Dividends and other appropriations

	2016		2015	
	Pence per share	£m	Pence per share	£m
Ordinary shares				
Interim				
2016 paid 28 September 2016	**51.3**	**961**		
2015 paid 30 September 2015			49.4	908
Final				
2015 paid 5 May 2016	**104.6**	**1,949**		
2014 paid 7 May 2015			100.6	1,862
	155.9	**2,910**	150.0	2,770

The Directors have recommended to shareholders a final dividend of 118.1 pence per share for the year ended 31 December 2016. If approved, this dividend will be paid to shareholders on 4 May 2017. 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 £2,194 million, which takes the total dividends declared in respect of 2016 to £3,155 million (2015: £2,851 million) representing 169.4 pence per share (2015: 154.0 pence per share).

9 Intangible assets

	2016					2015				
	Goodwill*	Computer software	Trademarks and similar intangibles	Assets in the course of development	Total	Goodwill*	Computer software	Trademarks and similar intangibles	Assets in the course of development	Total
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
1 January										
Cost	**9,324**	**918**	**1,015**	**180**	**11,437**	9,842	735	844	305	11,726
Accumulated amortisation and impairment		**(569)**	**(432)**		**(1,001)**		(530)	(392)		(922)
Net book value at 1 January	**9,324**	**349**	**583**	**180**	**10,436**	9,842	205	452	305	10,804
Differences on exchange	**1,690**	**2**	**96**	**7**	**1,795**	(681)	(3)	(36)	—	(720)
Additions										
- internal development	**—**	**11**	**—**	**49**	**60**	—	1	—	102	103
- acquisitions (note 24)	**9**	**—**	**33**	**—**	**42**	163	—	237	—	400
- separately acquired	**—**	**1**	**21**	**—**	**22**	—	2	—	—	2
Reallocations	**—**	**147**	**29**	**(176)**	**—**	—	225	2	(227)	—
Amortisation charge	**—**	**(72)**	**(133)**	**—**	**(205)**	—	(66)	(68)	—	(134)
Impairment	**—**	**—**	**(33)**	**—**	**(33)**	—	(10)	(4)	—	(14)
Disposals	**—**	**—**	**—**	**—**	**—**	—	(5)	—	—	(5)
31 December										
Cost	**11,023**	**1,054**	**1,255**	**60**	**13,392**	9,324	918	1,015	180	11,437
Accumulated amortisation and impairment		**(616)**	**(659)**		**(1,275)**		(569)	(432)		(1,001)
Net book value at 31 December	**11,023**	**438**	**596**	**60**	**12,117**	9,324	349	583	180	10,436

* The cost of Goodwill is shown net of impairment charges made in prior years.

Included in computer software and assets in the course of development are internally developed assets with a carrying value of £484 million (2015: £517 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.

Included in the net book value of trademarks and similar intangibles are trademarks relating to the acquisition of TDR d.o.o £105 million (2015: £144 million), Sudan £37 million (2015: £34 million), Chic Group £40 million (2015: £45 million), Skandinavisk Tobakskompagni (ST) £244 million (2015: £229 million), Tekel £16 million (2015: £19 million), Bentoel £15 million (2015: £19 million) and Protabaco £30 million (2015: £54 million). The Group has no future contractual commitments (2015: £15 million) related to intangible assets.

Impairment testing for intangible assets with indefinite lives including goodwill

Goodwill of £11,023 million (2015: £9,324 million) is included in intangible assets in the balance sheet of which the following are the significant acquisitions: Rothmans Group £4,809 million (2015: £4,131 million); Imperial Tobacco Canada £2,420 million (2015: £1,964 million); ETI (Italy) £1,406 million (2015: £1,216 million) and ST (principally Scandinavia) £1,061 million (2015: £913 million). The principal allocations of goodwill in the Rothmans' acquisition are to the cash-generating units of Eastern Europe, Western Europe and South Africa, with the remainder mainly relating to operations in the domestic and export markets in the United Kingdom and operations in Asia-Pacific.

In 2016 goodwill was allocated for impairment testing purposes to 18 (2015:14) individual cash-generating units — five in Asia-Pacific (2015: five), five in the Americas (2015: five), three in Western Europe (2015: two), three in EEMEA (2015: two) and two related to Next Generation Products (2015: nil).

	2016		2015	
	Carrying amount	Pre-tax discount rate	Carrying amount	Pre-tax discount rate
	£m	%	£m	%
Cash-Generating Unit				
Canada	**2,420**	**8.2**	1,964	8.5
Western Europe	**3,770**	**8.6**	3,249	8.6
Eastern Europe	**967**	**8.8**	832	8.5
South Africa	**656**	**10.1**	485	9.6
Australia	**785**	**8.6**	661	8.6
Singapore	**598**	**7.2**	511	7.2
Malaysia	**425**	**8.6**	372	8.7
Other	**1,402**		1,250	
Total	**11,023**		9,324	

The recoverable amounts of all cash-generating units have been determined on a value-in-use basis. The key assumptions for the recoverable amounts of all units are the budgeted volumes, operating margins and long-term growth rates, which directly impact the cash flows, and the discount rates used in the calculation. The long-term growth rate used is purely for the impairment testing of goodwill under IAS 36 and does not reflect long-term planning assumptions used by the Group for investment proposals or for any other assessments.

Pre-tax discount rates of between 7.2% and 20.0% (2015: 7.2% and 14.7%) were used, 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. The long-term growth rates and discount rates have been applied to the budgeted cash flows of each cash-generating unit. These cash flows have been determined by local management based on experience, specific market and brand trends, pricing expectations and costs, and have been endorsed by Group management as part of the consolidated Group budget.

The value-in-use calculations use cash flows based on detailed financial budgets prepared by management covering a one year period extrapolated over a 10-year horizon with growth of 5% in year 2. Cash flows for years 3 to 10 are extrapolated from year 2 cash flows for each relevant operating unit at 4% (2015: 4%) per annum, including 1% inflation (2015: 1% inflation), where after a total growth rate of 2% (2015: 2%) has been assumed. A 10-year horizon is considered appropriate based on the Group's history of profit and cash growth, its well balanced portfolio of brands and the industry in which it operates.

In some instances, such as recent acquisitions, start-up ventures or in other specific cases, the valuation is expanded to reflect the medium-term plan of the country or market management, spanning five years or beyond. 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 impairment.

10 Property, plant and equipment

	2016					2015				
	Freehold property	**Leasehold property**	**Plant and equipment**	**Assets in the course of construction**	**Total**	**Freehold property**	**Leasehold property**	**Plant and equipment**	**Assets in the course of construction**	**Total**
	£m	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
1 January										
Cost	**944**	**256**	**3,976**	**617**	**5,793**	998	260	4,109	570	5,937
Accumulated depreciation and impairment	**(288)**	**(126)**	**(2,343)**	**(15)**	**(2,772)**	(343)	(132)	(2,439)	(19)	(2,933)
Net book value at 1 January	**656**	**130**	**1,633**	**602**	**3,021**	655	128	1,670	551	3,004
Differences on exchange	**79**	**6**	**263**	**77**	**425**	(62)	—	(125)	(62)	(249)
Additions										
- acquisitions (note 24)	**—**	**—**	**—**	**—**	**—**	76	—	23	4	103
- separately acquired	**13**	**4**	**168**	**470**	**655**	6	7	129	353	495
Reallocations	**76**	**6**	**358**	**(440)**	**—**	23	9	211	(243)	—
Depreciation	**(20)**	**(9)**	**(308)**	**—**	**(337)**	(19)	(10)	(242)	—	(271)
Impairment	**—**	**(5)**	**(71)**	**(4)**	**(80)**	—	(2)	(17)	7	(12)
Disposals	**3**	**(4)**	**(11)**	**(1)**	**(13)**	(15)	(2)	(15)	(8)	(40)
Net reclassifications as held-for-sale	**(4)**	**(5)**	**(1)**	**—**	**(10)**	(8)	—	(1)	—	(9)
31 December										
Cost	**1,163**	**239**	**5,022**	**725**	**7,149**	944	256	3,976	617	5,793
Accumulated depreciation and impairment	**(360)**	**(116)**	**(2,991)**	**(21)**	**(3,488)**	(288)	(126)	(2,343)	(15)	(2,772)
Net book value at 31 December	**803**	**123**	**2,031**	**704**	**3,661**	656	130	1,633	602	3,021

Net book value of assets held under finance leases for 2016 was £27 million (2015: £24 million).

The Group's finance lease arrangements relate principally to the lease of vehicles and tobacco vending machines by the Group's subsidiaries in Canada and Japan respectively. Assets held under finance leases are secured under finance lease obligations included in note 20.

As explained in note 12, contributions to the British American Tobacco UK Pension Fund are secured by a charge over the Group's Head Office (Globe House). Globe House is included in freehold property above with a carrying value of £188 million (2015: £189 million).

	2016	**2015**
	£m	**£m**
Cost of freehold land within freehold property on which no depreciation is provided	**202**	193
Leasehold property comprises		
- net book value of long leasehold	**80**	119
- net book value of short leasehold	**43**	11
	123	130
Contracts placed for future expenditure	**29**	71

11 Investments in associates and joint ventures

	2016 £m	2015 £m
1 January	**6,938**	2,400
Total comprehensive income (note 5)	**3,662**	1,576
Dividends	**(1,024)**	(640)
Share buy-backs	**(24)**	—
Additions	**—**	3,628
Other equity movements	**(45)**	(26)
31 December	**9,507**	6,938
Non-current assets	**17,831**	14,800
Current assets	**2,439**	2,818
Non-current liabilities	**(8,552)**	(8,692)
Current liabilities	**(2,211)**	(1,988)
	9,507	6,938
Reynolds American (Group's share of the market value is £27,275 million (2015: £18,850 million))	**8,051**	5,749
ITC Ltd. (Group's share of the market value is £10,430 million (2015: £8,112 million))	**1,394**	1,136
Other listed associates (Group's share of the market value is £142 million (2015: £86 million))	**17**	14
Unlisted associates	**45**	39
	9,507	6,938

The principal associate undertakings of the Group are Reynolds American and ITC Ltd. (ITC) as shown under principal associate undertakings.

Reynolds American

	2016 £m	2015 £m
Non-current assets	**34,046**	28,666
Current assets	**3,480**	4,242
Non-current liabilities	**(20,089)**	(20,430)
Current liabilities	**(3,845)**	(3,459)
	13,592	9,019
Group's share of Reynolds American (42.2%)	**5,733**	3,804
Goodwill	**2,318**	1,945
Total Group's share of Reynolds American	**8,051**	5,749

On 30 July 2004, the Group completed the agreement to combine the US domestic business of Brown and Williamson (B&W), one of its subsidiaries, with RJ Reynolds. This combination resulted in the formation of Reynolds American, which was 58% owned by RJ Reynolds' shareholders and 42% owned by the Group. The Group has concluded that it does not have de facto control of Reynolds American because of the operation of the governance agreement between the Group and Reynolds American which ensures that the Group does not have the practical ability to direct the relevant activities of Reynolds American; in particular, the Group cannot nominate more than five of the directors (out of 13 or proportionally less if there are less than 13 directors) unless it owns 100% of Reynolds American or some other party owns more than 50%. In addition, there are no other contractual arrangements which would give the Group the ability to direct Reynolds American's operations. Manufacturing and cooperation agreements between Reynolds American and the Group have been agreed on an arm's length basis. However, details of the termination of the manufacturing agreement are disclosed in note 27.

On 12 June 2015, Reynolds American completed its acquisition of Lorillard, Inc. ("Lorillard") and related divestiture transactions to ITG Brands LLC, a subsidiary of Imperial Tobacco Group PLC (now Imperial Brands plc), after receiving the required regulatory approval. At the same time, the intention of which was announced on 15 July 2014, the Group invested US$4.7 billion (£3.0 billion) of cash in Reynolds American to maintain its 42% equity position in the enlarged business.

The Group recognised a deemed gain of US$931 million (£601 million), as part of the cost of investment. This has arisen as the contract to acquire shares is deemed to be a financial instrument and was fair valued through the profit and loss, in compliance with IAS 39. This has been treated as an adjusting item, in line with the Group's policy as described in note 4. Goodwill of US$529 million (£336 million) has also been recognised, being the difference between the Group's share of the net assets acquired by Reynolds American, and the deemed fair value of the consideration paid.

Reynolds American recognised a gain on divestiture of assets of US$4,861 million (2015: US$3,288 million). The Group's share of this net gain amounted to £941 million (2015: £371 million) (net of tax). This has been treated as an adjusting item, in line with the Group's policy, as described in note 5.

The Group recognised a reduction in the investment in Reynolds American of £24 million (2015: £nil) in respect of the Group's participation in the share buy-back programme conducted by Reynolds American during the year.

ITC Ltd.

ITC prepares accounts on a quarterly basis with a 31 March year end. As permitted by IAS 28, results up to 30 September 2016 have been used in applying the equity method. This is driven by the availability of information at the half year, to be consistent with the treatment in the Group's interim accounts. Any further information available after the date used for reporting purposes is reviewed and any material items adjusted for in the final results. The latest published information available is at 31 December 2016.

	2016	**2015**
	£m	**£m**
Non-current assets	**3,730**	2,432
Current assets	**2,834**	3,044
Non-current liabilities	**(258)**	(250)
Current liabilities	**(1,643)**	(1,447)
	4,663	3,779
Group's share of ITC Ltd. (2016: 29.89% (2015: 30.06%))	**1,394**	1,136

Additional information on associates is provided in the 'Group Companies and Undertakings' section to the Annual Report on pages 153–161.

12 Retirement benefit schemes

The Group's subsidiary undertakings operate around 170 retirement benefit arrangements worldwide. The majority of scheme members belong to defined benefit schemes, most of which are funded externally and many of which are closed to new entrants. The Group also operates a number of defined contribution schemes.

The liabilities arising in the defined benefit schemes are determined in accordance with the advice of independent, professionally qualified actuaries, using the projected unit credit method. All schemes are formally valued at least every three years.

The principal schemes are in the UK, Germany, Canada, the Netherlands and Switzerland. Together schemes in these territories account for over 85% of the total obligations of the Group's defined benefit schemes. These obligations consist mainly of final salary pension schemes which provide benefits to members in the form of a guaranteed level of pension payable for life. The level of benefits provided depends on members' length of service and their salary in the final years leading up to retirement.

In addition, the Group operates several healthcare benefit schemes, of which the most significant are in Canada. The liabilities in respect of healthcare benefits are also assessed by qualified independent actuaries, applying the projected unit credit method.

All of these arrangements, including funded schemes where formal trusts or equivalents are required, have been developed and are operated in accordance with local practices and regulations where applicable in the countries concerned. For example, in the UK, the main pension scheme is the British American Tobacco UK Pension Fund, which is established under trust law and has a corporate trustee that is required to run the scheme in accordance with the Scheme's Trust Deed and Rules and to comply with the Pension Scheme Act 1993, Pensions Act 1995, Pension Act 2004 and all the relevant legislation.

Responsibility for the governance of the schemes, including investment decisions and contribution schedules, lies with the trustees. The trustees for each arrangement will usually consist of representatives appointed by both the sponsoring company and the beneficiaries.

The majority of schemes are subject to local regulation regarding funding deficits. Contributions to defined benefit schemes are determined after consultation with the respective trustees and actuaries of the individual externally funded schemes and after taking into account regulatory requirements.

Contributions to the British American Tobacco UK Pension Fund have been agreed with the Trustee as part of a recovery plan to include £30 million a year to cover on-going service costs and additional contributions to eliminate a funding shortfall. Additional contributions were £78 million in 2016 and are planned to be £78 million in each of 2017 and 2018. These contributions will be used to achieve the statutory funding objective and thereafter to support attaining a lower risk investment strategy (noted below) and may be subject to renegotiation, dependant on funding levels. Total contributions payable are secured by a charge over the Group's Head Office (Globe House) up to a maximum of £150 million. The charge would be triggered in the event that the Group defaults on agreed contributions due to the Fund or if an insolvency event occurs with respect to the UK entity responsible for making the payments. The charge is due to be released in 2039 but may be released earlier by negotiation or if the assets of the Fund are sufficient to achieve certain funding levels. Under the rules of the scheme, any future surplus would be returnable to the Group by refund at the end of the life of the scheme. The funding commitment is therefore not considered onerous and in accordance with IFRIC 14 no additional liabilities have been recognised in respect of this commitment.

Payments made to pensioners by the operating companies in Germany, net of income on scheme assets, are deemed to be company contributions to the Contractual Trust Arrangements and are anticipated to be around £30 million in 2017 and £37 million per annum for the four years after that. Contributions to pension schemes in Canada, the Netherlands and Switzerland in total are anticipated to be around £13 million in 2017 and then £13 million per annum for the four years after that. Group contributions to pension schemes in 2017 are expected to be £173 million in total compared to £181 million in 2016.

The majority of benefit payments are from trustee administered funds; however, there are also a number of unfunded schemes where the sponsoring company meets the benefit payment obligation as it falls due. For unfunded schemes in the UK and Canada, 29% of the liabilities reported at year end are expected to be settled by the Group within ten years, 27% between ten and twenty years, 21% between twenty and thirty years, and 23% thereafter.

The funded arrangements in the Group have policies on investment management, including strategies over a preferred long term investment profile, and schemes in certain territories including Canada and the Netherlands manage their bond portfolios to match the weighted average duration of scheme liabilities. In addition, the main scheme in the UK has a target investment strategy such that, by 31 December 2018, the scheme will have moved to 20% return-seeking assets and 80% risk-reducing assets. Investments are diversified by type of investment, by investment sector, and where appropriate by country.

Through its defined benefit pension schemes and healthcare schemes, the Group is exposed to a number of risks, including:

Asset volatility:

The plan liabilities are calculated using discount rates set by reference to bond yields; if plan assets underperform this yield e.g. due to stock market volatility, this will create a deficit. However, most schemes hold a proportion of assets which are expected to outperform bonds in the long term, and the majority of schemes by value are subject to local regulation regarding funding deficits.

Changes in bond yields:

A decrease in corporate bond yields will increase scheme liabilities, although this will be partially offset by an increase in the value of the schemes' bond holdings or other hedging instruments.

Inflation risk:

Some of the Group's pension obligations are linked to inflation and higher inflation will lead to higher liabilities, although, in most cases, caps on the level of inflationary increases are in place in the scheme rules, while some assets and derivatives provide specific inflation protection.

Life expectancy:

The majority of the schemes' obligations are to provide benefits for the life of the member, so increases in life expectancy will result in an increase in the plans' liabilities. Assumptions regarding mortality and mortality improvements are regularly reviewed in line with actuarial tables and scheme specific experience.

The amounts recognised in the balance sheet are determined as follows:

	Pension schemes		Healthcare schemes		Total	
	2016	2015	2016	2015	2016	2015
	£m	£m	£m	£m	£m	£m
Present value of funded scheme liabilities	**(7,139)**	(5,944)	**(16)**	(12)	**(7,155)**	(5,956)
Fair value of funded scheme assets	**7,264**	6,076	**14**	10	**7,278**	6,086
	125	132	**(2)**	(2)	**123**	130
Unrecognised funded scheme surpluses	**(18)**	(11)	**—**	—	**(18)**	(11)
	107	121	**(2)**	(2)	**105**	119
Present value of unfunded scheme liabilities	**(371)**	(276)	**(105)**	(88)	**(476)**	(364)
	(264)	(155)	**(107)**	(90)	**(371)**	(245)
The above net liability is recognised in the balance sheet as follows:						
- retirement benefit scheme liabilities	**(719)**	(563)	**(107)**	(90)	**(826)**	(653)
- retirement benefit scheme assets	**455**	408	**—**	—	**455**	408
	(264)	(155)	**(107)**	(90)	**(371)**	(245)

The net liabilities of funded pension schemes by territory are as follows:

	Liabilities		Assets		Total	
	2016	2015	2016	2015	2016	2015
	£m	£m	£m	£m	£m	£m
- UK	**(3,529)**	(2,995)	**3,853**	3,291	**324**	296
- Germany	**(1,020)**	(822)	**872**	704	**(148)**	(118)
- Canada	**(796)**	(654)	**806**	661	**10**	7
- Netherlands	**(737)**	(588)	**777**	641	**40**	53
- Switzerland	**(370)**	(347)	**293**	278	**(77)**	(69)
- Rest of Group	**(687)**	(538)	**663**	501	**(24)**	(37)
Funded schemes	**(7,139)**	(5,944)	**7,264**	6,076	**125**	132

Of the Group's unfunded pension schemes 64% (2015: 62%) relate to arrangements in the UK, while 84% (2015: 83%) of the Group's unfunded Healthcare arrangements relate to arrangements in Canada.

The amounts recognised in the income statement are as follows:

	Pension schemes		Healthcare schemes		Total	
	2016	2015	2016	2015	2016	2015
	£m	£m	£m	£m	£m	£m
Defined benefit schemes						
Service cost						
- current service cost	**85**	85	**1**	1	**86**	86
- past service credit	**(43)**	(10)	**(1)**	—	**(44)**	(10)
Net interest on the net defined benefit liability						
- interest on scheme liabilities	**229**	215	**6**	5	**235**	220
- interest on scheme assets	**(230)**	(201)	**(1)**	(1)	**(231)**	(202)
- interest on unrecognised funded scheme surpluses	**2**	1	**—**	—	**2**	1
	43	90	**5**	5	**48**	95
Defined contribution schemes	**53**	43	**—**	—	**53**	43
Total amount recognised in the income statement (note 3(a))	**96**	133	**5**	5	**101**	138

The above charges are recognised within employee benefit costs in note 3(a) and include a credit of £17 million in 2016 (2015: £16 million charge) in respect of settlements, past service costs and defined contribution costs reported as part of the restructuring costs charged in arriving at profit from operations (see note 3(d)).

The movements in scheme liabilities are as follows:

	Pension schemes		Healthcare schemes		Total	
	2016	2015	2016	2015	2016	2015
	£m	£m	£m	£m	£m	£m
Present value at 1 January	**6,220**	6,881	**100**	113	**6,320**	6,994
Differences on exchange	**574**	(215)	**22**	(13)	**596**	(228)
Current service cost	**88**	86	**1**	1	**89**	87
Past service credit	**(44)**	(9)	**—**	—	**(44)**	(9)
Settlements	**(33)**	(20)	**(1)**	—	**(34)**	(20)
Interest on scheme liabilities	**238**	211	**6**	4	**244**	215
Contributions by scheme members	**4**	3	**—**	—	**4**	3
Benefits paid	**(381)**	(339)	**(8)**	(6)	**(389)**	(345)
Actuarial losses/(gains)						
- arising from changes in demographic assumptions	**(7)**	13	**—**	—	**(7)**	13
- arising from changes in financial assumptions	**911**	(335)	**1**	1	**912**	(334)
Experience gains	**(61)**	(56)	**(1)**	—	**(62)**	(56)
Present value at 31 December	**7,510**	6,220	**120**	100	**7,630**	6,320

Changes in financial assumptions principally relate to discount rate movements in both years.

Scheme liabilities by scheme membership:

	Pension schemes		Healthcare schemes		Total	
	2016	2015	2016	2015	2016	2015
	£m	£m	£m	£m	£m	£m
Active members	**1,358**	1,139	**22**	20	**1,380**	1,159
Deferred members	**1,306**	900	**2**	2	**1,308**	902
Retired members	**4,846**	4,181	**96**	78	**4,942**	4,259
Present value at 31 December	**7,510**	6,220	**120**	100	**7,630**	6,320

Approximately 95% of scheme liabilities in both years relate to guaranteed benefits.

The movements in funded scheme assets are as follows:

	Pension schemes		Healthcare schemes		Total	
	2016	2015	2016	2015	2016	2015
	£m	£m	£m	£m	£m	£m
Fair value of scheme assets at 1 January	**6,076**	6,253	**10**	13	**6,086**	6,266
Differences on exchange	**541**	(209)	**5**	(3)	**546**	(212)
Settlements	**(33)**	(19)	**—**	—	**(33)**	(19)
Interest on scheme assets	**238**	197	**1**	1	**239**	198
Company contributions	**181**	262	**—**	—	**181**	262
Contributions by scheme members	**5**	4	**—**	—	**5**	4
Benefits paid	**(360)**	(318)	**(1)**	(1)	**(361)**	(319)
Actuarial gains/(losses)	**616**	(94)	**(1)**	—	**615**	(94)
Fair value of scheme assets at 31 December	**7,264**	6,076	**14**	10	**7,278**	6,086

Fair value of scheme assets by category:

	Pension schemes		Healthcare schemes		Total	
	2016	**2015**	**2016**	**2015**	**2016**	**2015**
	£m	**£m**	**£m**	**£m**	**£m**	**£m**
Equities — listed	**1,697**	1,559	**5**	4	**1,702**	1,563
Equities — unlisted	**630**	557	**—**	—	**630**	557
Bonds — listed	**3,948**	3,092	**4**	3	**3,952**	3,095
Bonds — unlisted	**109**	43	**—**	—	**109**	43
Other assets — listed	**403**	94	**—**	3	**403**	97
Other assets — unlisted	**477**	731	**5**	—	**482**	731
Fair value of scheme assets at 31 December	**7,264**	6,076	**14**	10	**7,278**	6,086

Scheme assets have been diversified into equities, bonds and other assets and are typically invested via fund investment managers into both pooled and segregated mandates of listed and unlisted equities and bonds. In addition, certain scheme assets, including a portion of the assets held in the main UK pension scheme, are further diversified by investing in equities listed on non-UK stock exchanges via investment funds. In the above analysis investments via equity-based investment funds are shown under listed equities, and investments via bond-based investment funds are shown under listed bonds. Other assets include cash and other deposits, derivatives and other hedges (including liability driven investments funds and inflation opportunity funds), recoverable taxes, reinsurance contracts, infrastructure investments and investment property.

The actuarial gains and losses in both years principally relate to movements in the fair values of scheme assets and actual returns are stated net of applicable taxes and fund management fees. The fair values of listed scheme assets were derived from observable data including quoted market prices and other market data, including market values of individual segregated investments and of pooled investment funds where quoted. The fair values of unlisted assets were derived from cash flow projections of estimated future income after taking into account the estimated recoverable value of these assets.

The movements in the unrecognised scheme surpluses, recognised in other comprehensive income, are as follows:

	Pension schemes		Healthcare schemes		Total	
	2016	**2015**	**2016**	**2015**	**2016**	**2015**
	£m	**£m**	**£m**	**£m**	**£m**	**£m**
Unrecognised funded scheme surpluses at 1 January	**(11)**	(13)	**—**	—	**(11)**	(13)
Differences on exchange	**(4)**	3	**—**	—	**(4)**	3
Interest on unrecognised funded scheme surpluses	**(2)**	(1)	**—**	—	**(2)**	(1)
Movement in year (note 19)	**(1)**	—	**—**	—	**(1)**	—
Unrecognised funded scheme surpluses at 31 December	**(18)**	(11)	**—**	—	**(18)**	(11)

The principal actuarial assumptions (weighted to reflect individual scheme differences) used in the following principal countries are shown below. In both years, discount rates are determined by reference to normal yields on high quality corporate bonds at the balance sheet date. For countries where there is not a deep market in such corporate bonds, the yield on government bonds is used.

	2016					2015				
	UK	**Germany**	**Canada**	**Netherlands**	**Switzerland**	**UK**	**Germany**	**Canada**	**Netherlands**	**Switzerland**
Rate of increase in salaries (%)	**3.3**	**2.5**	**3.0**	**2.0**	**1.3**	4.6	2.3	3.3	2.0	1.3
Rate of increase in pensions in payment (%)	**3.3**	**1.8**	**Nil**	**1.1**	**Nil**	3.1	1.5	Nil	1.1	Nil
Rate of increase in deferred pensions (%)	**2.5**	**Nil**	**Nil**	**1.1**	**—**	2.3	Nil	Nil	1.1	—
Discount rate (%)	**2.6**	**1.7**	**3.7**	**1.9**	**0.6**	3.8	2.3	3.8	2.5	0.7
General inflation (%)	**3.3**	**1.8**	**2.0**	**2.0**	**1.0**	3.1	1.5	2.3	2.0	0.9

	2016					2015				
	UK	Germany	Canada	Netherlands	Switzerland	UK	Germany	Canada	Netherlands	Switzerland
Weighted average duration of liabilities (years)	**18.2**	**14.0**	**11.2**	**18.3**	**13.4**	16.9	13.0	11.1	17.9	14.6

For healthcare inflation in Canada, the assumption is 4.8% (2015: 4.5%). For the remaining pension schemes, typical assumptions are that real salary increases will be from 0% to 5.2% (2015: 0% to 6.5%) per annum and discount rates will be from 0% to 7.7% (2015: 0% to 7.7%) above inflation. Pension increases, where allowed for, are generally assumed to be in line with inflation.

Mortality assumptions are subject to regular review. The principal schemes used the following tables:

UK		91.5% S1NA (year of birth) table with the Continuous Mortality Investigation (2013) model with a 1.75% long-term improvement rate (both years)
Germany		Heubeck tables 2005G (both years)
Canada		CPM-2014 Private Table (both years)
Netherlands	2016:	AG Prognosetafel 2016
	2015:	AG Prognosetafel 2014
Switzerland	2016:	LPP/BVG 2015 Generational
	2015:	LPP 2010 tables

Based on the above, the weighted average life expectancy, in years, for mortality tables used to determine benefit obligations is as follows:

	UK		Germany		Canada		Netherlands		Switzerland	
	Male	Female	Male	Female	Male	Female	Male	Female	Male	Female
31 December 2016										
Member age 65 (current life expectancy)	**23.8**	**26.4**	**19.1**	**23.2**	**21.3**	**23.7**	**20.6**	**24.7**	**22.3**	**24.4**
Member age 45 (life expectancy at age 65)	**26.5**	**29.2**	**21.8**	**25.7**	**22.4**	**24.7**	**23.1**	**26.9**	**24.2**	**26.3**
31 December 2015										
Member age 65 (current life expectancy)	23.7	26.3	19.0	23.1	21.2	23.7	20.9	24.8	21.5	24.0
Member age 45 (life expectancy at age 65)	26.4	29.1	21.7	25.6	22.3	24.7	23.4	26.8	23.3	25.7

Valuation of retirement benefit schemes involves judgements about uncertain future events. Sensitivities in respect of the key assumptions used to measure the principal pension schemes as at 31 December 2016 are set out below. These sensitivities show the hypothetical impact of a change in each of the listed assumptions in isolation, with the exception of the sensitivity to inflation which incorporates the impact of certain correlating assumptions such as salary increases. While each of these sensitivities holds all other assumptions constant, in practice such assumptions rarely change in isolation, while asset values also change, and the impacts may offset to some extent.

	1 year increase	1 year decrease	0.25 percentage point increase	0.25 percentage point decrease
	£m	£m	£m	£m
Average life expectancy — increase/(decrease) of scheme liabilities	**228**	**(227)**		
Rate of inflation — increase/(decrease) of scheme liabilities			**213**	**(199)**
Discount rate — (decrease)/increase of scheme liabilities			**(256)**	**273**

A one percentage point increase in healthcare inflation would increase healthcare scheme liabilities by £14 million, and a one percentage point decrease would decrease liabilities by £12 million. The income statement effect of this change in assumption is not material.

13 Deferred tax

Net deferred tax assets/(liabilities) comprise:

	Stock relief	Excess of capital allowances over depreciation	Tax losses	Undistributed earnings of associates and subsidiaries	Retirement benefits	Fair value losses/ (gains)	Other temporary differences	Total
	£m	£m	£m	£m	£m	£m	£m	£m
At 1 January 2016	**30**	**(132)**	**53**	**(255)**	**48**	**43**	**(24)**	**(237)**
Differences on exchange	**6**	**(18)**	**13**	**(41)**	**4**	**11**	**(14)**	**(39)**
(Charged)/credited to the income statement	**(5)**	**98**	**23**	**(96)**	**1**	**(22)**	**(3)**	**(4)**
Credited/(charged) to other comprehensive income	**—**	**—**	**—**	**—**	**64**	**10**	**(4)**	**70**
Subsidiaries acquired (note 24)	**—**	**(6)**	**—**	**—**	**—**	**—**	**—**	**(6)**
At 31 December 2016	**31**	**(58)**	**89**	**(392)**	**117**	**42**	**(45)**	**(216)**
At 1 January 2015	23	(142)	46	(204)	79	39	(25)	(184)
Differences on exchange	(3)	12	(9)	4	(2)	3	(9)	(4)
Credited/(charged) to the income statement	10	(2)	16	(55)	(6)	(13)	46	(4)
(Charged)/credited to other comprehensive income	—	—	—	—	(23)	14	—	(9)
Subsidiaries acquired (note 24)	—	—	—	—	—	—	(36)	(36)
At 31 December 2015	30	(132)	53	(255)	48	43	(24)	(237)

The net deferred tax liabilities are reflected in the Group balance sheet as follows: deferred tax asset of £436 million and deferred tax liability of £652 million (2015: deferred tax asset of £326 million and deferred tax liability of £563 million), 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.

Deferred tax expected to be recovered within 12 months includes deferred tax assets of £119 million (2015: £133 million) and deferred tax liabilities of £372 million (2015: £348 million).

At the balance sheet date, the Group has not recognised a deferred tax asset in respect of unused tax losses of £542 million (2015: £804 million) which have no expiry date and unused tax losses of £761 million (2015: £698 million) which will expire within the next 10 years.

At the balance sheet date, the Group has not recognised a deferred tax asset in respect of deductible temporary differences of £534 million (2015: £737 million), which have no expiry date and £191 million (2015: £173 million), which will expire within the next 10 years.

At the balance sheet date, the Group has unused tax credits of £80 million (2015: £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 £0.7 billion (2015: £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

	2016	2015
	£m	£m
Trade receivables	**2,696**	2,355
Loans and other receivables	**1,619**	984
Prepayments and accrued income	**168**	175
	4,483	3,514
Current	**3,884**	3,266
Non-current	**599**	248
	4,483	3,514

Included in loans and other receivables, is £326 million (2015: £55 million) in respect of payments made by a Group subsidiary in relation to the Quebec Class Action, as detailed in note 28. The Group has determined that these payments are recoverable on conclusion of the on-going appeal and the deposit has not been discounted. While there is uncertainty over the timeframe of the appeal process, it is estimated that had discounting been applied the carrying value of the asset would have been reduced by approximately £20 million (2015: £4 million).

Amounts receivable from related parties including associated undertakings are shown in note 27.

Trade and other receivables have been reported in the balance sheet net of allowances as follows:

	2016	2015
	£m	£m
Gross trade and other receivables	**4,570**	3,565
Allowance account	**(87)**	(51)
Net trade and other receivables per balance sheet	**4,483**	3,514

The movements in the allowance account are as follows:

	2016	2015
	£m	£m
1 January	**51**	54
Differences on exchange	**11**	(9)
Provided in the year	**26**	8
Amounts reversed during the year	**(1)**	(2)
31 December	**87**	51

As at 31 December 2016, trade and other receivables of £60 million (2015: £75 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:

	2016	2015
	£m	£m
Less than three months	**39**	64
Between three and six months	**11**	5
Between six months and one year	**7**	4
Greater than one year	**3**	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: US dollar: 3.8% (2015: 4.5%), UK sterling: 5.4% (2015: 5.9%), Euro: 2.8% (2015: 1.8%) and other currencies: 3.8% (2015: 5.0%).

There is no material difference between the above amounts for trade and other receivables and their fair value due to the short-term duration of the majority of trade and other receivables as determined using discounted cash flow analysis. There is no concentration of credit risk with respect to trade receivables as the Group has a large number of internationally dispersed customers.

15 Available-for-sale investments

	2016	2015
	£m	£m
1 January	**72**	86
Differences on exchange	**10**	—
Additions and advances	**4**	17
Revaluations	**—**	14
Disposals and repayments	**(28)**	(45)
31 December	**58**	72
Current	**15**	35
Non-current	**43**	37
	58	72

The classification of these investments under the IFRS 13 fair value hierarchy is given in note 23.

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 all denominated in the functional currency of the subsidiary undertaking holding the investments.

16 Derivative financial instruments

The fair values of derivatives are determined based on market data (primarily yield curves, implied volatilities and exchange rates) to calculate the present value of all estimated flows associated with each derivative at the balance sheet date. In the absence of sufficient market data, fair values would be based on the quoted market price of similar derivatives. The classification of these derivative assets and liabilities under the IFRS 13 fair value hierarchy is given in note 23.

	2016		2015	
	Assets	Liabilities	Assets	Liabilities
	£m	£m	£m	£m
Fair value hedges				
- interest rate swaps	**179**	**14**	217	23
- cross-currency swaps	**261**	**—**	40	38
Cash flow hedges				
- interest rate swaps	**2**	**—**	—	—
- cross-currency swaps	**106**	**—**	9	—
- forward foreign currency contracts	**120**	**118**	77	70
Net investment hedges				
- forward foreign currency contracts	**23**	**233**	40	75
Held-for-trading*				
- interest rate swaps	**71**	**90**	52	70
- cross-currency swaps	**173**	**174**	4	11
- forward foreign currency contracts	**36**	**39**	57	30
Total	**971**	**668**	496	317
Current	**375**	**549**	209	187
Non-current	**596**	**119**	287	130
	971	**668**	496	317
Derivatives				
- in respect of net debt	**809**	**300**	373	164
- other	**162**	**368**	123	153
	971	**668**	496	317

* 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 change included in the income statement. These derivatives principally consist of forward foreign currency contracts which have been designated as hedges due to their value changes offsetting with other components of net finance costs relating to financial assets and financial liabilities. The Group does not use derivatives for speculative purposes. All derivatives are undertaken for risk management purposes.

For cash flow hedges, the timing of expected cash flows is as follows: Assets of £228 million (2015: £86 million) of which £99 million (2015: £73 million) is expected within one year, and £106 million (2015: £9 million) beyond 5 years and Liabilities of £118 million (2015: £70 million) of which £105 million (2015: £65 million) is expected within one year.

The Group's cash flow hedges are principally in respect of sales or purchases of inventory and certain debt instruments. A certain number of forward foreign currency contracts were used to manage the currency profile of external borrowings and are reflected in the currency table in note 20. Interest rate swaps have been used to manage the interest rate profile of external borrowings and are reflected in the re-pricing table in note 20.

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:

	2016				2015			
	Assets		Liabilities		Assets		Liabilities	
	Inflow	Outflow	Inflow	Outflow	Inflow	Outflow	Inflow	Outflow
	£m	£m	£m	£m	£m	£m	£m	£m
Within one year								
- forward foreign currency contracts	**7,168**	**(6,943)**	**11,419**	**(12,024)**	5,294	(5,133)	4,358	(4,491)
- cross-currency swaps	**391**	**(534)**	**499**	**(354)**	9	(21)	359	(362)
Between one and two years								
- forward foreign currency contracts	**1,152**	**(1,104)**	**571**	**(630)**	107	(103)	323	(332)
- cross-currency swaps	**37**	**(36)**	**—**	**—**	368	(373)	361	(368)
Between two and three years								
- forward foreign currency contracts	**24**	**(22)**	**13**	**(12)**	—	—	28	(28)
- cross-currency swaps	**66**	**(69)**	**—**	**—**	15	(32)	16	(16)
Between three and four years								
- cross-currency swaps	**35**	**(40)**	**—**	**—**	29	(47)	30	(32)
Between four and five years								
- cross-currency swaps	**802**	**(770)**	**—**	**—**	14	(35)	16	(18)
Beyond five years								
- cross-currency swaps	**1,429**	**(1,244)**	**—**	**—**	1,465	(1,500)	458	(537)
	11,104	**(10,762)**	**12,502**	**(13,020)**	7,301	(7,244)	5,949	(6,184)

The maturity dates of net-settled derivative financial instruments, which primarily relate to interest rate swaps, are as follows:

	2016		2015	
	Assets Inflow	Liabilities Outflow	Assets Inflow	Liabilities Outflow
	£m	£m	£m	£m
Within one year	**102**	**29**	82	46
Between one and two years	**71**	**15**	62	25
Between two and three years	**64**	**14**	49	11
Between three and four years	**46**	**13**	37	9
Between four and five years	**26**	**11**	20	8
Beyond five years	**40**	**22**	28	19
	349	**104**	278	118

17 Inventories

	2016 £m	2015 £m
Raw materials and consumables	**2,230**	1,635
Finished goods and work in progress	**3,312**	2,359
Goods purchased for resale	**251**	253
	5,793	4,247

Inventories pledged as security for liabilities amount to £nil (2015: £8 million). Write-offs taken to other operating expenses in the Group income statement comprise £127 million (2015: £73 million), including amounts relating to restructuring costs.

18 Cash and cash equivalents

	2016 £m	2015 £m
Cash and bank balances	**1,628**	1,325
Cash equivalents	**576**	638
	2,204	1,963

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:

	2016 £m	2015 £m
Functional currency	**1,748**	1,679
US dollar	**195**	167
Euro	**159**	50
Other currency	**102**	67
	2,204	1,963

In the Group cash flow statement, net cash and cash equivalents are shown after deducting bank overdrafts and accrued interest where applicable, as follows:

	2016 £m	2015 £m
Cash and cash equivalents as above	**2,204**	1,963
Less overdrafts and accrued interest	**(553)**	(233)
Net cash and cash equivalents	**1,651**	1,730

Cash and cash equivalents include restricted amounts of £157 million (2015: £169 million), principally due to exchange control regulations in certain countries.

19 Capital and reserves — reconciliation of movement in total equity

	Attributable to owners of the parent						
	Share capital	Share premium, capital redemption and merger reserves	Other reserves	Retained earnings	Total attributable to owners of the parent	Non-controlling interests	Total equity
	£m	£m	£m	£m	£m	£m	£m
1 January 2016	**507**	**3,927**	**(1,294)**	**1,754**	**4,894**	**138**	**5,032**
Comprehensive income and expense							
Profit for the year	**—**	**—**	**—**	**4,648**	**4,648**	**191**	**4,839**
Differences on exchange							
- subsidiaries	**—**	**—**	**1,218**	**—**	**1,218**	**52**	**1,270**
- associates	**—**	**—**	**1,425**	**—**	**1,425**	**—**	**1,425**
Cash flow hedges							
- net fair value gains	**—**	**—**	**28**	**—**	**28**	**1**	**29**
- reclassified and reported in profit for the year	**—**	**—**	**38**	**—**	**38**	**—**	**38**
- reclassified and reported in net assets	**—**	**—**	**(12)**	**—**	**(12)**	**—**	**(12)**
Available-for-sale investments							
- net fair value losses in respect of associates net of tax	**—**	**—**	**(10)**	**—**	**(10)**	**—**	**(10)**
Net investment hedges							
- net fair value losses	**—**	**—**	**(837)**	**—**	**(837)**	**—**	**(837)**
- differences on exchange on borrowings	**—**	**—**	**(124)**	**—**	**(124)**	**—**	**(124)**
Tax on items recognised directly in other comprehensive income that may be reclassified subsequently to profit or loss (note 6(f))	**—**	**—**	**(19)**	**—**	**(19)**	**—**	**(19)**
Retirement benefit schemes							
- net actuarial losses in respect of subsidiaries (note 12)	**—**	**—**	**—**	**(231)**	**(231)**	**3**	**(228)**
- surplus recognition and minimum funding obligations in respect of subsidiaries (note 12)	**—**	**—**	**—**	**—**	**—**	**(1)**	**(1)**
- actuarial gains in respect of associates net of tax (note 5)	**—**	**—**	**—**	**20**	**20**	**—**	**20**
Tax on items recognised directly in other comprehensive income that will not be reclassified subsequently to profit or loss (note 6(f))	**—**	**—**	**—**	**36**	**36**	**—**	**36**
Other changes in equity							
Employee share options							
- value of employee services	**—**	**—**	**—**	**71**	**71**	**—**	**71**
- proceeds from shares issued	**—**	**4**	**—**	**—**	**4**	**—**	**4**
Dividends and other appropriations							
- ordinary shares (note 8)	**—**	**—**	**—**	**(2,910)**	**(2,910)**	**—**	**(2,910)**
- to non-controlling interests	**—**	**—**	**—**	**—**	**—**	**(156)**	**(156)**
Purchase of own shares							
- held in employee share ownership trusts	**—**	**—**	**—**	**(64)**	**(64)**	**—**	**(64)**
Non-controlling interests — acquisitions (note 24(d))	**—**	**—**	**—**	**4**	**4**	**(4)**	**—**
Other movements	**—**	**—**	**—**	**3**	**3**	**—**	**3**
31 December 2016	**507**	**3,931**	**413**	**3,331**	**8,182**	**224**	**8,406**

Notes on the Accounts (Continued)

	Attributable to owners of the parent						
	Share capital	Share premium, capital redemption and merger reserves	Other reserves	Retained earnings	Total attributable to owners of the parent	Non-controlling interests	Total equity
	£m	£m	£m	£m	£m	£m	£m
1 January 2015	507	3,923	(498)	1,578	5,510	304	5,814
Comprehensive income and expense							
Profit for the year	—	—	—	4,290	4,290	232	4,522
Differences on exchange							
- subsidiaries	—	—	(953)	—	(953)	(53)	(1,006)
- associates	—	—	336	—	336	—	336
Cash flow hedges							
- net fair value losses	—	—	(98)	—	(98)	(1)	(99)
- reclassified and reported in profit for the year	—	—	14	—	14	1	15
- reclassified and reported in net assets	—	—	(45)	—	(45)	—	(45)
Available-for-sale investments							
- net fair value gains in respect of subsidiaries	—	—	14	—	14	—	14
- reclassified and reported in profit for the year	—	—	(10)	—	(10)	—	(10)
- net fair value gains in respect of associates net of tax	—	—	1	—	1	—	1
Net investment hedges							
- net fair value losses	—	—	(118)	—	(118)	—	(118)
- differences on exchange on borrowings	—	—	42	—	42	—	42
Tax on items recognised directly in other comprehensive income that may be reclassified subsequently to profit or loss (note 6(f))	—	—	21	—	21	—	21
Retirement benefit schemes							
- net actuarial gains in respect of subsidiaries (note 12)	—	—	—	283	283	—	283
- actuarial gains in respect of associates net of tax (note 5)	—	—	—	3	3	—	3
Tax on items recognised directly in other comprehensive income that will not be reclassified subsequently to profit or loss (note 6(f))	—	—	—	(23)	(23)	—	(23)
Other changes in equity							
Employee share options							
- value of employee services	—	—	—	50	50	—	50
- proceeds from shares issued	—	4	—	—	4	—	4
Dividends and other appropriations							
- ordinary shares (note 8)	—	—	—	(2,770)	(2,770)	—	(2,770)
- to non-controlling interests	—	—	—	—	—	(238)	(238)
Purchase of own shares							
- held in employee share ownership trusts	—	—	—	(46)	(46)	—	(46)
Non-controlling interests — acquisitions (note 24(d))	—	—	—	(1,642)	(1,642)	(107)	(1,749)
Other movements	—	—	—	31	31	—	31
31 December 2015	507	3,927	(1,294)	1,754	4,894	138	5,032

Details relating to the allotted share capital, and movements therein, are included in note 4 of the Parent Company financial statements.

(a) Share premium account, capital redemption reserves and merger reserves comprise:

	Share premium account	Capital redemption reserves	Merger reserves	Total
	£m	£m	£m	£m
1 January 2015	74	101	3,748	3,923
31 December 2015	78	101	3,748	3,927
31 December 2016	**82**	**101**	**3,748**	**3,931**

The share premium account includes the difference between the value of shares issued and their nominal value. The increase of £4 million (2015: £4 million) relates solely to ordinary shares issued under the Company's share option schemes. These schemes are described in the Remuneration Report.

On the purchase of own shares as part of the share buy-back programme for shares which are cancelled, a transfer is made from retained earnings to the capital redemption reserve equivalent to the nominal value of shares purchased. Purchased shares which are not cancelled are classified as treasury shares and presented as a deduction from total equity.

Total equity attributable to owners of the parent is stated after deducting the cost of treasury shares which include £4,845 million (2015: £4,845 million) for shares repurchased and not cancelled and £208 million (2015: £204 million) in respect of the cost of own shares held in employee share ownership trusts.

In 1999, shares were issued for the acquisition of the Rothmans International B.V. Group, and the difference between the fair value of shares issued and their nominal value was credited to merger reserves.

Notes on the Accounts (Continued)

(b) Information on the principal components of non-controlling interests is provided in note 29.

Movements in other reserves and retained earnings (which are after deducting treasury shares) shown above comprise:

	Translation reserve	Hedging reserve	Available-for-sale reserve	Revaluation reserve	Other	Total other reserves	Retained earnings	
							Treasury shares	Other
	£m	£m	£m	£m	£m	£m	£m	£m
1 January 2016	**(2,062)**	**(33)**	**49**	**179**	**573**	**(1,294)**	**(5,049)**	**6,803**
Comprehensive income and expense								
Profit for the year	—	—	—	—	—	—	—	4,648
Differences on exchange								
- subsidiaries	1,218	—	—	—	—	1,218	—	—
- associates	1,425	—	—	—	—	1,425	—	—
Cash flow hedges								
- net fair value gains	—	28	—	—	—	28	—	—
- reclassified and reported in profit for the year	—	38	—	—	—	38	—	—
- reclassified and reported in net assets	—	(12)	—	—	—	(12)	—	—
Available-for-sale investments								
- net fair value losses in respect of associates net of tax	—	—	(10)	—	—	(10)	—	—
Net investment hedges								
- net fair value losses	(837)	—	—	—	—	(837)	—	—
- differences on exchange on borrowings	(124)	—	—	—	—	(124)	—	—
Tax on items recognised directly in other comprehensive income that may be reclassified subsequently to profit or loss (note 6(f))	(2)	(17)	—	—	—	(19)	—	—
Retirement benefit schemes								
- net actuarial losses in respect of subsidiaries (note 12)	—	—	—	—	—	—	—	(231)
- actuarial gains in respect of associates net of tax (note 5)	—	—	—	—	—	—	—	20
Tax on items recognised directly in other comprehensive income that will not be reclassified subsequently to profit or loss (note 6(f))	—	—	—	—	—	—	—	36
Other changes in equity								
Employee share options								
- value of employee services	—	—	—	—	—	—	—	71
Dividends and other appropriations								
- ordinary shares (note 8)	—	—	—	—	—	—	—	(2,910)
Purchase of own shares								
- held in employee share ownership trusts	—	—	—	—	—	—	(64)	—
Non-controlling interests — acquisitions (note 24(d))	—	—	—	—	—	—	—	4
Other movements	—	—	—	—	—	—	60	(57)
31 December 2016	**(382)**	**4**	**39**	**179**	**573**	**413**	**(5,053)**	**8,384**

	Translation reserve	Hedging reserve	Available-for-sale reserve	Revaluation reserve	Other	Total other reserves	Retained earnings	
							Treasury shares	Other
	£m	£m	£m	£m	£m	£m	£m	£m
1 January 2015	(1,369)	75	44	179	573	(498)	(5,073)	6,651
Comprehensive income and expense								
Profit for the year	—	—	—	—	—	—	—	4,290
Differences on exchange								
- subsidiaries	(953)	—	—	—	—	(953)	—	—
- associates	336	—	—	—	—	336	—	—
Cash flow hedges								
- net fair value losses	—	(98)	—	—	—	(98)	—	—
- reclassified and reported in profit for the year	—	14	—	—	—	14	—	—
- reclassified and reported in net assets	—	(45)	—	—	—	(45)	—	—
Available-for-sale investments								
- net fair value gains in respect of subsidiaries	—	—	14	—	—	14	—	—
- reclassified and reported in profit for the year	—	—	(10)	—	—	(10)	—	—
- net fair values gains in respect of associates net of tax	—	—	1	—	—	1	—	—
Net investment hedges								
- net fair value losses	(118)	—	—	—	—	(118)	—	—
- differences on exchange on borrowings	42	—	—	—	—	42	—	—
Tax on items recognised directly in other comprehensive income that may be reclassified subsequently to profit or loss	—	21	—	—	—	21	—	—
Retirement benefit schemes								
- net actuarial losses in respect of subsidiaries (note 12)	—	—	—	—	—	—	—	283
- actuarial losses in respect of associates net of tax (note 5)	—	—	—	—	—	—	—	3
Tax on items recognised directly in other comprehensive income that will not be reclassified subsequently to profit or loss	—	—	—	—	—	—	—	(23)
Other changes in equity								
Employee share options								
- value of employee services	—	—	—	—	—	—	—	50
- proceeds from shares issued	—	—	—	—	—	—	—	—
Dividends and other appropriations								
- ordinary shares (note 8)	—	—	—	—	—	—	—	(2,770)
Purchase of own shares								
- held in employee share ownership trusts	—	—	—	—	—	—	(46)	—
- share buy-back programme	—	—	—	—	—	—	—	—
Non-controlling interests — acquisitions (note 24(d))	—	—	—	—	—	—	—	(1,642)
Other movements	—	—	—	—	—	—	70	(39)
31 December 2015	(2,062)	(33)	49	179	573	(1,294)	(5,049)	6,803

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 £142 million (2015: £50 million loss) and £2 million (2015: £22 million gain) were reported within revenue and raw materials and consumables respectively, together with a loss of £6 million (2015: £8 million loss) reported in other operating expenses, a gain of £9 million (2015: £nil) reported in other operating income and a gain of £93 million (2015: £18 million gain) reported within net finance costs.

Other reserves comprise:

(a) £483 million which arose in 1998 from merger accounting in a Scheme of Arrangement and Reconstruction whereby British American Tobacco p.l.c. acquired the entire share capital of B.A.T Industries p.l.c. and the share capital of that company's principal financial services subsidiaries 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:

	2016	2015
	£m	£m
Translation reserve		
Net investment hedges		
- net fair value losses	**(2)**	—
	(2)	—
Hedging reserve		
Cash flow hedges		
- net fair value (gains)/losses	**(11)**	38
- reclassified and reported in profit for the year	**(6)**	(17)
	(17)	21
Retained earnings		
- actuarial losses/(gains) in respect of subsidiaries	**36**	(23)
	36	(23)
Owners of the parent	**17**	(2)
Total tax recognised in other comprehensive income for the year (note 6(f))	**17**	(2)

20 Borrowings

	Currency	Maturity dates	Interest rates	2016	2015
				£m	£m
Eurobonds	Euro	2017 to 2045	0.4% to 5.4%	**7,704**	6,603
	Euro	2018	3m EURIBOR +50bps	**341**	294
	UK sterling	2019 to 2055	1.8% to 7.3%	**4,241**	3,413
	US dollar	2019	1.6%	**527**	203
	Swiss franc	2016	CHF 3m LIBOR + 16bps	**—**	238
	Swiss franc	2021 to 2026	0.7% to 1.4%	**526**	446
Bonds issued pursuant to Rule 144A and RegS under the US Securities Act (as amended)	US dollar	2017 to 2025	1.9% to 9.5%	**4,472**	4,208
	US dollar	2018	USD 3m LIBOR + 51bps	**405**	339
Bonds and notes				**18,216**	15,744
Commercial paper				**254**	505
Other loans				**110**	236
Bank loans				**336**	258
Bank overdrafts				**553**	232
Finance leases				**26**	26
				19,495	17,001

The interest on the commercial paper referred to in the table above is based on USD LIBOR plus a margin ranging between 22 and 77 basis points and EURIBOR plus a margin ranging between 20 and 29 basis points (2015: USD LIBOR plus a margin ranging between 25 and 43 basis points).

Current borrowings per the balance sheet include interest payable of £229 million at 31 December 2016 (2015: £210 million). Included within borrowings are £7,157 million (2015: £7,394 million) of borrowings subject to fair value hedges where their amortised cost has been increased by £295 million (2015: £201 million) in the table above.

The fair value of borrowings is estimated to be £20,592 million (2015: £20,448 million). £19,126 million (2015: £19,059 million) has been calculated using quoted market prices and is within level 1 of the fair value hierarchy. £1,466 million (2015: £1,389 million) has been calculated based on discounted cash flow analysis and is within level 2 of the fair value hierarchy.

The amounts secured on Group assets as at 31 December 2016 is £26 million (2015: £34 million), including finance leases of £26 million (2015: £26 million) and amounts secured on certain inventory of the Group (see note 17).

Borrowings are repayable as follows:

	Per balance sheet		Contractual gross maturities	
	2016	**2015**	**2016**	**2015**
	£m	**£m**	**£m**	**£m**
Within one year	**3,007**	2,195	**3,587**	2,451
Between one and two years	**1,391**	1,337	**1,870**	1,905
Between two and three years	**1,756**	1,619	**2,220**	2,110
Between three and four years	**1,577**	1,141	**1,961**	1,519
Between four and five years	**1,925**	1,325	**2,292**	1,665
Beyond five years	**9,839**	9,384	**12,560**	11,902
	19,495	17,001	**24,490**	21,552

The contractual gross maturities in each year include the borrowings maturing in that year together with forecast interest payments on all borrowings which are outstanding for all or part of that year.

Borrowings are denominated in the functional currency of the subsidiary undertaking or other currencies as shown below:

	Functional currency	US dollar	UK sterling	Euro	Canadian dollar	Other currencies	Total
	£m	£m	£m	£m	£m	£m	£m
31 December 2016							
Total borrowings	**5,088**	**5,524**	**—**	**8,066**	**—**	**817**	**19,495**
Effect of derivative financial instruments							
- cross-currency swaps	**1,866**	**18**	**—**	**(1,895)**	**—**	**(255)**	**(266)**
- forward foreign currency contracts	**(770)**	**524**	**—**	**(547)**	**220**	**497**	**(76)**
	6,184	**6,066**	**—**	**5,624**	**220**	**1,059**	**19,153**
31 December 2015							
Total borrowings	5,858	4,872	330	4,974	—	967	17,001
Effect of derivative financial instruments							
- cross-currency swaps	2,215	15	(325)	(1,637)	—	(217)	51
- forward foreign currency contracts	(401)	541	—	(481)	178	161	(2)
	7,672	5,428	5	2,856	178	911	17,050

The exposure to interest rate changes when borrowings are re-priced is as follows:

	Within 1 year	Between 1-2 years	Between 2-3 years	Between 3-4 years	Between 4-5 years	Beyond 5 years	Total
	£m	£m	£m	£m	£m	£m	£m
31 December 2016							
Total borrowings	**3,753**	**624**	**1,756**	**1,576**	**1,925**	**9,861**	**19,495**
Effect of derivative financial instruments							
- interest rate swaps	**2,241**	**(202)**	**(250)**	**(1,119)**	**(755)**	**85**	**—**
- cross-currency swaps	**1,884**	**—**	**—**	**(17)**	**—**	**(2,133)**	**(266)**
	7,878	**422**	**1,506**	**440**	**1,170**	**7,813**	**19,229**
31 December 2015							
Total borrowings	2,988	1,337	986	1,140	1,324	9,226	17,001
Effect of derivative financial instruments							
- interest rate swaps	4,196	35	(509)	(250)	(1,940)	(1,532)	—
- cross-currency swaps	1,333	—	—	(15)	—	(1,267)	51
	8,517	1,372	477	875	(616)	6,427	17,052

Finance lease liabilities per the balance sheet and on a contractual gross maturity basis are payable as follows:

Finance lease liabilities per the balance sheet and on a contractual gross maturity basis with £10 million (2015: £7 million) repayable within one year, £16 million (2015: £18 million) repayable between one and five years, and £nil (2015: £1 million) repayable beyond five years. There is no material difference between the repayable principal and the total gross cash flows shown above.

The Group's undrawn committed borrowing facilities (see note 23) total £3,212 million (2015: £3,260 million) with £3,000 million (2015: £3,000 million) expiring between four and five years.

The Group defines net debt as follows:

	2016	2015
	£m	£m
Borrowings	**19,495**	17,001
Derivatives in respect of net debt:		
- assets (note 16)	**(809)**	(373)
- liabilities (note 16)	**300**	164
Cash and cash equivalents (note 18)	**(2,204)**	(1,963)
Current available-for-sale investments (note 15)	**(15)**	(35)
	16,767	14,794

21 Provisions for liabilities and charges

	Restructuring of existing businesses	Employee related benefits	Fox River	Other provisions	Total
	£m	£m	£m	£m	£m
1 January 2016	**89**	**38**	**160**	**282**	**569**
Differences on exchange	**15**	**8**	**—**	**46**	**69**
Provided in respect of the year	**120**	**14**	**20**	**150**	**304**
Utilised during the year	**(34)**	**(20)**	**(17)**	**(78)**	**(149)**
31 December 2016	**190**	**40**	**163**	**400**	**793**
Analysed on the balance sheet as					
- current	**86**	**27**	**19**	**275**	**407**
- non-current	**104**	**13**	**144**	**125**	**386**
	190	**40**	**163**	**400**	**793**

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 2016 and 2015 are as described in note 3(d). While some elements of the non-current provisions of £104 million will unwind over several years,

as termination payments are made over extended periods in some countries, it is estimated that approximately 65% will unwind within five years.

Employee related benefits mainly relate to employee benefits other than post-employment benefits. The principal components of these provisions are gratuity and termination awards, and 'jubilee' payments due after a certain service period. It is estimated that approximately 17% of the non-current provisions of £13 million will unwind within five years.

A provision of £274 million was made in 2011 for a potential claim under a 1998 settlement agreement entered into by a Group subsidiary in respect of the clean-up of sediment in the Fox River. On 30 September 2014, the Group, NCR, Appvion and Windward Prospects entered into the Funding Agreement. The details of this agreement are explained in note 28. This agreement led to payments of £6 million in 2016 (2015: £9 million). In addition, the Group incurred legal costs of £11 million (2015: £8 million) which were also charged against the provision. In light of the conclusion of the Funding Agreement, the sums that the Group agreed to pay thereunder, as well as the available information in relation to the extent of the clean-up related costs, the Group reviewed the Fox River provision and increased the provision by £20 million in 2016 owing to the significant devaluation of GBP against USD. It is expected that the non-current provision will unwind within five years.

On 10 February 2017, a decision was delivered on the further hearing related to a payment of dividends by Windward to Sequana in May 2009. Further details are provided in note 28.

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 reversals of £41 million (2015: £18 million) for restructuring of existing businesses, £2 million (2015: £nil) for employee benefits and £61 million (2015: £6 million) for other provisions.

22 Trade and other payables

	2016 £m	2015 £m
Trade payables	**1,281**	1,056
Duty, excise and other taxes	**4,573**	3,481
Accrued charges and deferred income	**1,140**	931
FII GLO deferred income (note 6(b))	**963**	963
Social security and other taxation	**21**	15
Sundry payables	**397**	520
	8,375	6,966
Current	**7,335**	5,937
Non-current	**1,040**	1,029
	8,375	6,966

Accrued charges and deferred income include £19 million of deferred income (2015: £14 million) and £8 million (2015: £10 million) in respect of interest payable. FII GLO deferred income of £963 million relates to receipts in 2015, in respect of the Franked Investment Income Government Litigation Order (see note 6(b)). Amounts payable to related parties including associated undertakings are shown in note 27.

There is no material difference between the above amounts for trade and other payables and their fair value due to the short-term duration of the majority of trade and other payables, as determined using discounted cash flow analysis.

Trade and other payables are predominantly denominated in the functional currencies of subsidiary undertakings with less than 5% in other currencies (2015: less than 7%).

23 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 20) and equity (see note 19). 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-backs 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's average cost of debt in 2016 is 3.1% (2015: 3.1%).

The Group manages its financial risks in line with the classification of its financial assets and liabilities in the Group's balance sheet and related notes. The Group's management of specific risks is dealt with as follows:

Liquidity risk

It is the policy of the Group to maximise financial flexibility and minimise refinancing risk by issuing debt with a range of maturities, generally matching the projected cash flows of the Group and obtaining this financing from a wide range of providers. The Group has a target average centrally managed debt maturity of at least five years with no more than 20% of centrally managed debt maturing in a single rolling year. As at 31 December 2016, the average centrally managed debt maturity was 8.2 years (2015: 7.9 years) and the highest proportion of centrally managed debt maturing in a single rolling year was 18.1% (2015: 15.0%).

It is Group policy that short-term sources of funds (including drawings under both the Group US$3 billion US commercial paper programme, and the Group £1 billion euro commercial paper ("ECP") programme) are backed by undrawn committed lines of credit and cash. Commercial paper is issued by B.A.T. International Finance p.l.c. and guaranteed by British American Tobacco p.l.c. At 31 December 2016, commercial paper of £254 million was outstanding (2015: £505 million).

The Group utilises cash pooling and zero balancing bank account structures in addition to intercompany loans and borrowings to mobilise cash efficiently within the Group. The key objectives of Treasury in respect of cash and cash equivalents are to protect their principal value, 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 a solid investment-grade credit rating. In October 2016, following the proposed offer to acquire the remaining 57.8% of Reynolds American not already owned by the Group, Moody's placed the rating (A3) under review for downgrade. S&P also placed the credit rating (A-) on Credit Watch with negative implications. Following announcement of the agreement in January 2017, Moody's and S&P revised the Group's rating to Baa2 and BBB+ with a stable outlook respectively. The Group intends to follow disciplined deleveraging post completion of the transaction and is seeking to recover to Baa1/BBB+ in the medium term. The Group is confident of its continued ability to successfully access the debt capital markets.

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 2016, cash and cash equivalents include £193 million invested in money market funds (2015: £334 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 are expected to inhibit the Group's operations or funding plans.

Currency risk

The Group is subject to exposure on the translation of the net assets of foreign currency subsidiaries and associates into its reporting currency, sterling. The Group's primary balance sheet translation exposures are to the US dollar, Canadian dollar, euro, Danish krone, Swiss franc, South African rand, Russian rouble, Brazilian real,

Australian dollar, Malaysian ringgit, Singaporean dollar and Indian rupee. 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 2016, the currency profile of the Group's gross debt, after taking into account derivative contracts, was 31% (2015: 32%) US dollar, 29% (2015: 30%) euro, 1% (2015: 1%) Canadian dollar, 28% (2015: 30%) sterling, and 11% (2015: 7%) other currencies.

The Group faces currency exposures arising from the translation of profits earned in foreign currency subsidiaries and associates and joint arrangements; these exposures are not normally hedged. Exposures also arise from:

(i) foreign currency denominated trading transactions undertaken by subsidiaries. These exposures comprise committed and highly probable forecast sales and purchases, which are offset wherever possible. The remaining exposures are hedged within the Treasury policies and procedures with forward foreign exchange contracts and options, which are designated as hedges of the foreign exchange risk of the identified future transactions; and

(ii) forecast dividend flows from subsidiaries to the centre. To ensure cash flow certainty, the Group enters into forward foreign exchange contracts which are designated as net investment hedges of the foreign exchange risk arising from the investments in these subsidiaries.

IFRS 7 requires a sensitivity analysis that shows the impact on the income statement and on items recognised directly in other comprehensive income of hypothetical changes of exchange rates in respect of non-functional currency financial assets and liabilities held across the Group. All other variables are held constant although, in practice, market rates rarely change in isolation. Financial assets and liabilities held in the functional currency of the Group's subsidiaries, as well as non-financial assets and liabilities and translation risk, are not included in the analysis. The Group considers a 10% strengthening or weakening of the functional currency against the non-functional currency of its subsidiaries as a reasonably possible change. The impact is calculated with reference to the financial asset or liability held as at the year end, unless this is unrepresentative of the position during the year.

A 10% strengthening of functional currencies against non-functional currencies would result in pre-tax profit being £2 million higher (2015: £3 million lower) and items recognised directly in other comprehensive income being £413 million higher (2015: £326 million higher). A 10% weakening of functional currencies against non-functional currencies would result in pre-tax profit being £4 million lower (2015: £2 million higher) and items recognised directly in other comprehensive income being £505 million lower (2015: £398 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 2016 it is 12.2 times (2015: 11.6 times). The only externally imposed capital requirement the Group has is in respect of its centrally managed banking facilities, which require a gross interest cover of at least 4.5 times.

In order to manage its interest rate risk, the Group maintains both floating rate and fixed rate debt. The Group sets targets (within overall guidelines) for the desired ratio of floating to fixed rate debt on both a gross and net basis (at least 50% fixed on a net basis in the short to the medium-term) as a result of regular reviews of market conditions and strategy by the Corporate Finance Committee and the board of the main central finance company. At 31 December 2016, the relevant ratios of floating to fixed rate borrowings were 26:74 (2015: 44:56) on a gross basis and 15:85 (2015: 33:67) on a net basis. Underlying borrowings are arranged on both a fixed rate and a floating rate basis and, where appropriate, the Group uses derivatives, primarily interest rate swaps, to vary

the fixed and floating mix. The interest rate profile of liquid assets is taken into account in determining the net interest rate exposure.

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 £37 million lower (2015: £65 million lower). A 100 basis point decrease in interest rates, or less where applicable, would result in pre-tax profit being £16 million higher (2015: £40 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 aims to transact with counterparties with strong investment grade credit ratings. However, the Group recognises that due to the need to operate over a large geographic footprint, this will not always be possible. Counterparty credit risk is managed on a global basis by limiting the aggregate amount and duration of exposure to any one counterparty, taking into account its credit rating. The credit ratings of all counterparties are reviewed regularly.

The Group ensures that it has sufficient counterparty credit capacity of requisite quality to undertake all anticipated transactions throughout its geographic footprint, while at the same time ensuring that there is no geographic concentration in the location of counterparties.

With the following exceptions, 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 2014, the Group entered into a guarantee arrangement in respect of the borrowings of the non-controlling interest in relation to the capital injection made to the Group's Algerian business. The maximum exposure under the arrangement would be £4 million (2015: £3 million). In addition, the Group has entered into short term risk participation agreements in relation to certain leaf supply arrangements and the maximum exposure under these would be £105 million (2015: £105 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 repeated periodically to ensure that the hedge has remained, and is expected to remain highly effective.

Fair value estimation

The fair values of financial assets and liabilities with maturities of less than one year, other than derivatives, are assumed to approximate their book values. For other financial instruments which are measured at fair value in the balance sheet, the basis for fair values is described below.

Fair value hierarchy

The following table presents the Group's financial assets and liabilities that are measured at fair value in accordance with the IFRS 13 classification hierarchy:

	2016				2015			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
	£m	£m	£m	£m	£m	£m	£m	£m
Assets at fair value								
Available-for-sale investments (note 15)	**15**	**—**	**43**	**58**	35	—	37	72
Derivatives relating to					—	—	—	
- interest rate swaps (note 16)	**—**	**252**	**—**	**252**	—	269	—	269
- cross-currency swaps (note 16)	**—**	**540**	**—**	**540**	—	53	—	53
- forward foreign currency contracts (note 16)	**—**	**179**	**—**	**179**	—	174	—	174
Assets at fair value	**15**	**971**	**43**	**1,029**	35	496	37	568
Liabilities at fair value								
Derivatives relating to								
- interest rate swaps (note 16)	**—**	**104**	**—**	**104**	—	93	—	93
- cross-currency swaps (note 16)	**—**	**174**	**—**	**174**	—	49	—	49
- forward foreign currency contracts (note 16)	**—**	**390**	**—**	**390**	—	175	—	175
Liabilities at fair value	**—**	**668**	**—**	**668**	—	317	—	317

Level 2 financial instruments are not traded in an active market, but the fair values are based on quoted market prices, broker/dealer quotations, or alternative pricing sources with reasonable levels of price transparency. The Group's level 2 financial instruments include OTC derivatives.

Netting arrangements of derivative financial instruments

The gross fair value of derivative financial instruments as presented in the Group balance sheet, together with the Group's rights of offset associated with recognised financial assets and recognised financial liabilities subject to enforceable master netting arrangements and similar agreements, is summarised as follows:

	2016			2015		
	Amount presented in the Group balance sheet*	Related amounts not offset in the Group balance sheet	Net amount	Amount presented in the Group balance sheet*	Related amounts not offset in the Group balance sheet	Net amount
	£m	£m	£m	£m	£m	£m
Financial Assets						
- Derivative Financial Instruments (note 16)	**971**	**(502)**	**469**	496	(272)	224
Financial Liabilities						
- Derivative Financial Instruments (note 16)	**(668)**	**502**	**(166)**	(317)	272	(45)
	303	**—**	**303**	179	—	179

* No financial instruments have been offset in the Group balance sheet.

The Group is subject to master netting arrangements in force with financial counterparties with whom the Group trades derivatives.

The master netting arrangements determine the proceedings should either party default on their obligations. In case of any event of default the non-defaulting party will calculate the sum of the replacement cost of

outstanding transactions and amounts owed to it by the defaulting party. If that sum exceeds the amounts owed to the defaulting party, the defaulting party will pay the balance to the non-defaulting party. If the sum is less than the amounts owed to the defaulting party, the non-defaulting party will pay the balance to the defaulting party.

24 Business combinations, disposals and other changes in the Group

(a) Ten Motives

On 20 April 2016, the Group completed the acquisition of 100% of Ten Motives Limited and 10 Motives Limited, comprising a UK based e-cigarette business with particular strength in traditional grocery and convenience channels. The fair value of consideration payable was £56 million, of which £6 million is contingent on post-acquisition targets being met. The fair values and book values of net assets acquired were not materially different except for the recognition of trademarks and similar intangibles of £33 million. Provisional goodwill of £21 million arising on this transaction represents a strategic premium to increase the Group's share of the UK non-tobacco market.

(b) TDR d.o.o. ("TDR")

On 30 May 2015, the Group signed an agreement to acquire TDR and other tobacco and retail assets from Adris Grupa d.d. for a total enterprise value of €550 million. TDR is the leading independent cigarette manufacturer in Central Europe with a market leading position in Croatia and a position of scale in Bosnia and Serbia which will provide the Group with the opportunity to significantly grow its business in the region. The transaction was completed on 30 September 2015. Part of the consideration is contingent upon certain targets being met post-acquisition, and £5 million of this was paid in January 2017. As noted in the 2015 Annual Report, part of the transaction was still subject to final agreement of adjustments for certain liabilities. This occurred in 2016 with an adjustment of £12 million to net assets acquired and a corresponding reduction to goodwill.

(c) Other acquisitions

On 22 September 2015, the Group announced the agreement to acquire 100% of the CHIC Group from private shareholders and the transaction concluded on 30 December 2015. The fair value of the consideration payable was £82 million, of which £30 million is contingent on achievement of certain post-acquisition targets. £6 million of this was paid during 2016. The fair value and book values of net assets acquired were not materially different except for the recognition of trademarks and similar intangibles of £45 million and the recognition of a deferred tax liability of £8 million. Goodwill of £40 million arising on this transaction represents a strategic premium to enter the non-tobacco market.

In addition, on 17 November 2015, the Group acquired 100% of Blue Nile Cigarette Company Limited from a private shareholder. The fair value of the consideration payable was £45 million of which £8 million is contingent on achievement of certain post-acquisition targets. The fair value and book values of net assets acquired were not materially different except for the recognition of trademarks and similar intangibles of £34 million. Goodwill of £7 million arising on this transaction represents a strategic premium to enter this market and acquire a manufacturing base in Sudan.

(d) Non-controlling interests

Souza Cruz S.A.

On 16 October 2015, the Group announced that it had concluded the auction related to its public tender offer in Brazil to acquire up to all of the 24.7% of Souza Cruz shares not currently owned by the Group and to delist the company. As at 31 December 2015 the Group owned 99.1% of Souza Cruz. The cost of acquiring these shares up to end of December 2015 was £1,660 million. The compulsory acquisition of the remaining minority shares was approved on 5 February 2016, with Souza Cruz becoming a wholly-owned subsidiary as at that date. The cost of acquiring the remaining shares was £70 million.

BAT Chile Operaciones, S.A.

During 2015, the Group acquired a further 0.2% interest in BAT Chile Operaciones, S.A. at a cost of £1 million. This increased the Group's shareholding to 99%. This transaction is shown as a £1 million reduction to reserves attributable to the owners of the parent in note 19.

BAT Central America S.A.

During 2015, the Group acquired a further 9% interest in BAT Central America S.A. at a cost of £16 million. This increased the Group's shareholding to approximately 88%. This transaction is shown as a £14 million reduction to reserves attributable to the owners of the parent and a £2 million reduction in reserves attributable to non-controlling interests in note 19.

(e) Associates and joint ventures

Reynolds American

As explained in note 11, on 12 June 2015 the Group invested US$4.7 billion (£3.0 billion) of cash into Reynolds American to maintain its 42% equity position in the enlarged business.

25 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 (40% of grant (2015: 50%)), operating cash flow (20% of grant (2015: 0%)), total shareholder return (20% of grant (2015: 25%)) and net turnover (20% of grant (2015: 25%)). Total shareholder return combines the share price and dividend performance of the Company by reference to one comparator group. 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 were granted in May of 2016 (2015: March).

Deferred Share Bonus Scheme (DSBS)

Free ordinary shares released three years from date of grant and may be subject to forfeit if a participant leaves employment before the end of the three year holding period. Participants receive a separate payment equivalent to a proportion of the dividend payment during the holding period. Both equity and cash-settled deferred shares are granted in March each year.

The Group also has a number of other arrangements which are not material for the Group and these are as follows:

Sharesave Scheme (SAYE)

Options granted in March each year from 2011 onwards (previously November until 2009 and no options were granted during 2010) by invitation at a 20% discount to the market price. Options to this equity-settled scheme are exercisable at the end of a three year or five year savings contract. Participants are not entitled to dividends prior to the exercise of the options. The maximum amount that can be saved by a participant in this way is £6,000 in any tax year.

Share Reward Scheme (SRS) and International Share Reward Scheme (ISRS)

Free shares granted in April each year (maximum £3,600 in any year (2015: £3,000)) under the equity-settled scheme are subject to a three year holding period. Participants receive dividends during the holding period which are reinvested to buy further shares.

Partnership Share Scheme

Open to all eligible employees, where employees can allocate part of their pre-tax salary to purchase shares in British American Tobacco p.l.c. The maximum amount that can be allocated in this way to any individual is £1,800 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:

	2016		2015	
	Equity-settled	Cash-settled	Equity-settled	Cash-settled
	£m	£m	£m	£m
LTIP (note (a))	**25**	**6**	1	3
DSBS (note (b))	**40**	**7**	44	7
Other schemes	**6**	**—**	5	—
Total recognised in the income statement (note 3(a))	**71**	**13**	50	10

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 2016 and 2015:

	2016		2015	
	Vested	Unvested	Vested	Unvested
	£m	£m	£m	£m
LTIP	**1.1**	**8.9**	1.3	3.5
DSBS	**0.3**	**11.3**	0.1	10.4
Total liability	**1.4**	**20.2**	1.4	13.9

(a) Long-Term Incentive Plan

Details of the movements for the equity and cash-settled LTIP scheme during the years ended 31 December 2016 and 31 December 2015, were as follows:

	2016		2015	
	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	**5,225**	**414**	5,198	485
Granted during the period	**1,772**	**139**	2,141	160
Exercised during the period	**(262)**	**(77)**	(255)	(92)
Forfeited during the period	**(1,398)**	**(69)**	(1,859)	(139)
Outstanding at end of year	**5,337**	**407**	5,225	414
Exercisable at end of year	**148**	**23**	189	34

The weighted average British American Tobacco p.l.c. share price at the date of exercise for share options exercised during the period was £45.80 (2015: £35.39) for equity-settled and £47.00 (2015: £35.52) for cash-settled options.

The outstanding shares for the year ended 31 December 2016 had a weighted average remaining contractual life of 8.2 years (2015: 8.2 years) for the equity-settled scheme and 7.9 years (2015: 7.9 years) for the cash-settled share-based payment arrangements.

(b) Deferred Share Bonus Scheme

Details of the movements for the equity and cash-settled DSBS scheme during the years ended 31 December 2016 and 31 December 2015, were as follows:

	2016		2015	
	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	**3,395**	**451**	4,262	555
Granted during the period	**1,316**	**148**	1,072	172
Exercised during the period	**(1,395)**	**(161)**	(1,874)	(260)
Forfeited during the period	**(91)**	**(15)**	(65)	(16)
Outstanding at end of year	**3,225**	**423**	3,395	451
Exercisable at end of year	**35**	**4**	22	1

The weighted average British American Tobacco p.l.c. share price at the date of exercise for share options exercised during the financial year was £42.26 (2015: £35.05) for equity-settled and £41.97 (2015: £34.42) for cash-settled options.

The outstanding shares for the year ended 31 December 2016 had a weighted average remaining contractual life of 1.3 years (2015: 1.2 years) for the equity-settled scheme and 1.2 years (2015: 1.3 years) for the cash-settled scheme.

Valuation assumptions

Assumptions used in the Black-Scholes models to determine the fair value of share options at grant date were as follows:

	2016		2015	
	LTIP	**DSBS**	**LTIP**	**DSBS**
Expected volatility (%)	**18**	**17**	17	17
Average expected term to exercise (years)	**3.5**	**3.0**	3.5	3.0
Risk-free rate (%)	**0.6**	**0.6**	0.8	0.7
Expected dividend yield (%)	**3.6**	**3.7**	4.0	4.0
Share price at date of grant (£)	**42.34**	**40.08**	36.25	36.25
Fair value at grant date (£)	**26.53**	**35.82**	14.29	32.15

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:

	2016	2015
	LTIP	**LTIP**
Average share price volatility FMCG comparator group (%)	**19**	19
Average correlation FMCG comparator group (%)	**36**	33

Fair values determined from the Black-Scholes and Monte-Carlo models use assumptions revised at the end of each reporting period for cash-settled share-based payment arrangements.

The expected British American Tobacco p.l.c. share price volatility was determined taking account of the return index (the share price index plus the dividend reinvested) over a five year period. The FMCG share price volatility and correlation was 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 pay-out calculation is based on expectations published in analysts' forecasts.

26 Group employees

The average number of persons employed by the Group and its associates during the year, including Directors, was 85,335 (2015: 87,577).

	2016 Number	2015 Number
Asia-Pacific	**13,002**	14,671
Americas	**14,691**	15,662
Western Europe	**13,444**	12,645
EEMEA	**11,569**	11,691
Subsidiary undertakings	**52,706**	54,669
Associates	**32,629**	32,908
	85,335	87,577

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.

27 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 with CTBAT International Limited are not included in these disclosures as it is a joint operation.

As explained in note 30, the Group announced the proposed merger with Reynolds American on 17 January 2017.

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 £221 million (2015: £145 million). The Group's share of dividends from associates, included in other net income in the table below, was £1,024 million (2015: £640 million).

	2016 £m	2015 £m
Transactions		
- revenue	**370**	38
- purchases	**(298)**	(270)
- other net income	**1,023**	639
Amounts receivable at 31 December	**270**	190
Amounts payable at 31 December	**(2)**	(20)

On 17 December 2012, a wholly owned subsidiary of the Group, BATUS Japan Inc. ("BATUSJ"), entered into an Amendment and Extension Agreement (referred to as the Amendment) with a wholly owned subsidiary of Reynolds American, R.J. Reynolds Tobacco Company (referred to as RJRTC). The Amendment modifies the American blend Cigarette Manufacturing Agreement (referred to as the 2010 Agreement), effective as of 1 January 2010.

Prior to the Amendment, the term of the 2010 Agreement was scheduled to expire on 31 December 2014, subject to early termination and extension provisions. Pursuant to the Amendment, the Manufacturing Agreement would remain in effect beyond 31 December 2014, provided that either RJRTC or BATUSJ may terminate the Manufacturing Agreement by furnishing three years' notice to the other party, such notice was given in January 2016. As a result of early termination of this agreement the Group agreed to a compensation payment of US$90 million of which US$7 million was paid to RJRTC on 22 September 2016, with the Group recognising the full expense of US$90 million as required by IFRS in 2016. The balance is due in March 2017.

During 2016, the Group received proceeds of £23 million in respect of its participation in the share buy-back programme conducted by Reynolds American. This programme ceased in the fourth quarter of 2016.

During 2016, the Group acquired the remaining 1% interest in Souza Cruz at a cost of £70 million. This transaction is shown as a £4 million increase in reserves attributable to the owners of the parent and a £4 million reduction in reserves attributable to non-controlling interests in note 19.

For comparative purposes, prior year's acquisitions are disclosed in note 24.

As explained in note 12, contributions to the British American Tobacco UK Pension Fund are secured by a charge over the Group's Head Office (Globe House) up to a maximum of £150 million.

The key management personnel of British American Tobacco consist of the members of the Board of Directors of British American Tobacco p.l.c. and the members of the Management Board. No such person had any material interest during the year in a contract of significance (other than a service contract) with the Company or any subsidiary company. The term key management personnel in this context includes the respective members of their households.

	2016	2015
	£m	£m
The total compensation for key management personnel, including Directors, was:		
- salaries and other short-term employee benefits	**18**	20
- post-employment benefits	**3**	4
- share-based payments	**12**	11
	33	35

There were no other long-term benefits applicable in respect of key personnel other than those disclosed in the remuneration report.

28 Contingent liabilities and financial commitments

1. The Group is subject to contingencies pursuant to requirements that it complies with relevant laws, regulations and standards.
2. Failure to comply could result in restrictions in operations, damages, fines, increased tax, increased cost of compliance, interest charges, reputational damage or other sanctions. These matters are inherently difficult to quantify. In cases where the Group has an obligation as a result of a past event existing at the balance sheet date, it is probable that an outflow of economic resources will be required to settle the obligation and if the amount of the obligation can be reliably estimated, a provision will be recognised based on best estimates and management judgement.
3. There are, however, contingent liabilities in respect of litigation, taxes in some countries and guarantees for which no provisions have been made.

General Litigation

Product Liability Litigation

4. Group companies, notably Brown & Williamson Holdings, Inc. (formerly Brown & Williamson Tobacco Corporation) ("B&W") as well as other leading cigarette manufacturers, are defendants in a number of product liability cases. In a number of these cases, the amounts of compensatory and punitive damages sought are significant.

Indemnity

5. On 30 July 2004, B&W completed the combination of the assets, liabilities and operations of its US tobacco business with R.J. Reynolds Tobacco Company ("RJRT"), a wholly-owned subsidiary of R.J. Reynolds Tobacco Holdings, Inc., pursuant to which Reynolds American Inc. was formed (the "Business Combination"). As part of the Business Combination, B&W contributed to RJRT all of the assets and liabilities of its US cigarette and tobacco business, subject to specified exceptions, in exchange for a 42 per cent equity ownership interest in Reynolds American Inc.
6. As a result of the Business Combination, RJRT assumed all liabilities of B&W (except liabilities to the extent relating to businesses and assets not contributed by B&W to RJRT and other limited categories of liabilities) and contributed subsidiaries or otherwise to the extent related to B&W's tobacco business as conducted in the United States on or prior to 30 July 2004. In addition, RJRT agreed to indemnify B&W and each of its associates (other than Reynolds American Inc. and its subsidiaries) against, among other matters,

all losses (including those arising from Environmental Tobacco Smoke ("ETS") claims), liabilities, damages, expenses, judgments, attorneys' fees, etc., to the extent relating to or arising from such assumed liabilities or the assets contributed by B&W to RJRT (the "RJRT Indemnification").

7. 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").

8. 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.

9. Included in the US Litigation section below are all significant cases where B&W and/or a UK company is named as a defendant and all cases where RJRT is named as a defendant as a successor to B&W (the "RJRT Successor Cases"). The RJRT Successor Cases are covered by the RJRT Indemnification.

US Litigation

10. The total number of US tobacco product liability cases pending at 31 December 2016 involving B&W was approximately 4,925 (compared to approximately 5,237 in 2015). Of these, 2,020 cases are RJRT Successor Cases. For all of the 4,925 cases involving B&W, British American Tobacco Group companies have the protection of the RJRT Indemnification. As at 31 December 2016, British American Tobacco (Investments) Limited ("Investments") has been served as a co-defendant in one of those cases (2015:1). No other UK-based Group company has been served as a co-defendant in any US tobacco product liability case pending as at 31 December 2016. 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

11. 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.

12. At 31 December 2016, one US medical reimbursement suit was pending against B&W by an Indian tribe in an Indian tribal court in South Dakota. No other suits are pending against B&W by county or other political subdivisions of the states.

Class Actions

13. At 31 December 2016, B&W was named as a defendant in five separate actions attempting to assert claims on behalf of classes of persons allegedly injured or financially impacted through smoking or where classes of tobacco claimants have been certified. If the classes are or remain certified, separate trials may be needed to assess individual plaintiffs' damages. Two of the five class actions against B&W allege that the use of the terms 'lights' and 'ultralights' constitutes unfair and deceptive trade practices. Similar class action suits have been filed in a number of states against individual cigarette manufacturers and their parent corporations.

    (a) Black is a 'lights' class action filed in November 2000, which in 2008, the Circuit Court, City of St. Louis, Missouri stayed pending US Supreme Court review in Good v Altria Group, Inc. A status conference is scheduled for 5 June 2017.

    (b) Howard is a 'lights' class action filed in February 2000 in the Circuit Court, Madison County, Illinois, currently stayed pending resolution of Price v Philip Morris, Inc.

    (c) Jones is a case filed in December 1998 in the Circuit Court, Jackson County, Missouri; the action was brought by tobacco product users and purchasers on behalf of all similarly situated Missouri consumers alleging that the plaintiffs' use of the defendants' tobacco products has caused them to become addicted to nicotine, and seeks an unspecified amount of compensatory and punitive damages. There has been limited activity in this case.

(d) Parsons is a case filed in February 1998 in the Circuit Court, Ohio County, West Virginia currently stayed pending final resolution of a motion brought by the plaintiffs, and because three defendants filed bankruptcy petitions.

(e) Young is a case filed in November 1997 in the Circuit Court, Orleans Parish, Louisiana. This 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 manufactured by the defendants, and who allegedly suffered injury as a result of that exposure, seeks an unspecified amount of compensatory and punitive damages, and has been stayed since 2004.

14. Engle Class Action (Florida): In 2000 three class representatives in the Engle class action were awarded US$12.7 million in compensatory damages and punitive damages against B&W were assessed at US$17.6 billion. This decision was appealed and ultimately resulted in the Supreme Court in July 2006 decertifying the class and allowing judgments entered for only two of the three Engle class representatives to stand. Putative Engle class members were permitted to file individual lawsuits against the Engle defendants within one year of the Supreme Court's decision (subsequently extended to 11 January 2008).

Engle progeny cases, as at 31 December 2016:

	Engle progeny cases in which B&W has been served (both state and federal courts in Florida)	**Engle progeny cases in which RJRT is named as a successor to B&W**
Number of cases	30	2,008
Total number of plaintiffs in all cases	86	2,618

Phase three trials of individual Engle class members, as at 31 December 2016:

	Additional Phase 3 Engle Trials naming RJRT as successor to B&W proceeding to verdict
Total number of trials	109
Number of trials resulting in plaintiffs' verdicts	62
Total damages awarded in final judgments against RJRT as successor to B&W (approximately)	US$283,252,767
Amount of overall damages comprising 'compensatory damages' (approximately)	US$143,915,963 (of overall US$283,252,767)
Amount of overall damages comprising 'punitive damages' (approximately)	US$139,336,803 (of overall US$283,252,767)
Number of adverse judgments appealed by RJRT	48*
Number of adverse judgments (not yet appealed), in which RJRT still has time to file an appeal	13

* Of the 48 adverse judgments appealed by RJRT:

a. 22 appeals remain undecided (including 2 that have petitions for review pending in the Florida Supreme Court); and

b. 26 were decided and/or closed. Of these 26 appeals, 21 had the judgments affirmed in favour of plaintiffs, 6 had the liability findings affirmed but the damages award vacated and the matter remanded to the trial court and 3 were reversed and the matter remanded to the trial court for a new trial on all issues. One appeal was voluntarily dismissed. RJRT has paid damages to plaintiffs in 16 cases that are now closed. The total damages awarded may vary depending on the outcome of pending appeals.

15. The Florida legislature applies a US$200 million bond cap to all phase three Engle progeny cases in the aggregate. Individual bond caps for individual cases vary depending on the number of judgments in effect at a given time. Judicial attempts by several plaintiffs in the Engle progeny cases to challenge the bond cap as violating the Florida Constitution have failed.

(c) Individual Cases

	As at the:	**Total number of cases**		
Cases pending against B&W which were filed by or on behalf of individuals and in which it is contended that diseases or deaths have been caused by cigarette smoking or by exposure to ETS	31 December 2015	2,995		
	31 December 2016	2,899	2,407	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.
			393	Cases brought in consolidated proceedings in West Virginia, where the first phase of the trial began on 15 April 2013 and on 15 May 2013 the jury returned a verdict for defendants on all but one of plaintiffs' claims; the verdict is currently on appeal.
			30	Engle progeny cases that have been filed directly against B&W (please see earlier table on page 142).
			69	Cases filed by other individuals.

16. In addition to the 2,008 Engle progeny cases which name RJRT as successor to B&W, there are 12 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.

UK-Based Group Companies

17. As at 31 December 2016, Investments has been served in one dormant individual action in the US (Perry) in which there has been no activity since 1998 following the plaintiff's death in 1997.

18. In December 2016, the Company received a complaint in an individual personal injury action pending in state court in Seattle, Washington (Ratcliff). The plaintiff asserts various claims, including state law product liability, fraud and statutory claims, against multiple defendants, including the Company, and alleges that she developed malignant mesothelioma from amongst other things her exposure to asbestos found in certain talc-containing cosmetic products and powders. The case is currently in discovery. The Company filed a motion to dismiss for improper service and lack of personal jurisdiction on 8 February 2017, which motion remains pending.

Product Liability Outside the United States

19. As at 31 December 2016:

    (a) active product liability claims against the Group's companies existed in 13 markets outside the US. The only markets with more than five claims were Argentina, Brazil, Canada, Chile, Italy and Nigeria.

    (b) medical reimbursement actions are being brought in Angola, Argentina, Brazil, Canada, Nigeria and South Korea.

    (c) class actions are being brought in Brazil, Canada, Italy and Venezuela.

(a) Medical reimbursement cases Angola

20. In or about November 2016, BAT Angola affiliate Sociedade Unificada de Tabacos de Angola ("SUT") was served with a collective action filed in the Provincial Court of Luanda, 2nd Civil Section, by the consumer association Associação Angolana dos Direitos do Consumidor ("AADIC"). The lawsuit seeks damages allegedly incurred by the Angolan Instituto Nacional do Controlo do Cancro ("INCC") for the cost of treating tobacco-related disease, non-material damages allegedly suffered by certain individual smokers on the rolls of INCC, and the mandating of certain cigarette package warnings. SUT filed its answer to the claim on or about 5 December 2016. The case remains pending.

Argentina

21. In 2007, the non-governmental organisation the Argentina Tort Law Association ("ATLA") and Emma Mendoza Voguet brought a reimbursement action against Nobleza Piccardo S.A.I.C.y.F. ("Nobleza") and Massalín Particulares. The case is being heard in the Contentious Administrative Court and is currently at the evidentiary stage.

Brazil

22. In August 2007, the São Paulo Public Prosecutor's Office filed a medical reimbursement claim against Souza Cruz S.A. ("Souza Cruz"). A similar claim was lodged against Philip Morris. On 4 October 2011, the Court dismissed the action against Souza Cruz, with a judgment on the merits. The plaintiffs' appeal to the Court of Appeal failed by unanimous vote (3 to 0). The Public Prosecutor's Office has since filed a Special Appeal to the Superior Court of Justice.

Canada

23. Following the implementation of legislation enabling provincial governments to recover healthcare costs directly from tobacco manufacturers ten actions for recovery of healthcare costs arising from the treatment of smoking and health-related diseases have been brought. These proceedings name various Group companies as defendants, including the Company, Investments, B.A.T Industries p.l.c. ("Industries"), Carreras Rothmans Limited (collectively the "UK Companies") and Imperial Tobacco Canada Limited ("Imperial"), the Group's operating company in Canada, and are proceeding in British Columbia, New Brunswick, Newfoundland and Labrador, Ontario, Quebec, Manitoba, Alberta, Saskatchewan, Nova Scotia and Prince Edward Island ("PEI"). The enabling legislation is in force in all ten provinces. In addition, legislation has received Royal Assent in two of the three territories in Canada, but has yet to be proclaimed into force. In Quebec, three Canadian manufacturers, including Imperial, challenged the enabling legislation. This challenge was dismissed.

Canadian province	Act pursuant to which Claim was brought	Companies named as Defendants	Current stage
British Columbia	Tobacco Damages and Health Care Costs Recovery Act 2000	Imperial Investments Industries Other former Rothmans Group companies All have been served.	The underlying medical reimbursement action remains at a preliminary case management stage. Damages have not been quantified by the province, but the federal government is seeking CAD$5 million jointly from all the defendants in respect of costs. On 13 February 2017 the province delivered an expert report dated October 2016, quantifying its damages in the amount of CAD$118 billion. No hearing date has been set.
New Brunswick	Tobacco Damages and Health Care Costs Recovery Act 2006	Imperial and the UK Companies have all been named as defendants and served.	Both Imperial's and the UK Companies' defences have been filed, document production is underway and discoveries are substantially complete. Damages have recently been calculated by the province as in the range of $25-$60 billion from 1954 to 2060. No trial date has been set.
Ontario	Tobacco Damages and Health Care Costs Recovery Act 2009	Imperial and the UK Companies have all been named as defendants and served.	This case is at an early case management stage and Imperial and the UK Companies have filed defences. The province has stated its claim to be worth CAD$50 billion. No trial date has been set.
Newfoundland and Labrador	Tobacco Health Care Costs Recovery Act 2006	Imperial and the UK Companies have all been named as defendants and served.	The case is now under case management and Imperial and the UK Companies have filed defences. Damages have not been quantified by the province. No trial date has been set.

Canadian province	Act pursuant to which Claim was brought	Companies named as Defendants	Current stage
Saskatchewan	Tobacco Damages and Health Care Costs Recovery Act 2012	Imperial and the UK Companies have all been named as defendants and served.	This case is at an early case management stage. A standstill agreement was negotiated under which defences were filed and the matter will remain in abeyance until document production begins in September 2017. Damages have not been quantified by the province. No trial date has been set.
Manitoba	Tobacco Damages Health Care Costs Recovery Act 2006	Imperial and the UK Companies have all been named as defendants and served.	This case is at an early case management stage. A standstill agreement has been negotiated, under which defences were filed and the matter will remain in abeyance until document production begins in early 2017. Damages have not been quantified by the province. No trial date has been set.
Alberta	Crown's Right of Recovery Act 2009	Imperial and the UK Companies have all been named as defendants and served.	This case is at an early case management stage and Imperial and the UK Companies have filed defences. The province has stated its claim to be worth CAD$10 billion. No trial date has been set.
Quebec	Tobacco Related Damages and Health Care Costs Recovery Act 2005	Imperial, Investments, Industries, and Carreras Rothmans Limited have been named as defendants and served.	Imperial and the other Canadian manufacturers' constitutional challenge to the Quebec Medicaid Legislation was unsuccessful at both first instance and on appeal. Another manufacturer sought leave to appeal to the Supreme Court of Canada. Leave was refused on 5 May 2016. This case is at an early case management stage. Defences have been filed. Motions over admissibility of documents and damages discovery have been filed but not heard. The province is seeking CAD$60 billion. No trial date has been set.
Prince Edward Island	Tobacco Damages and Health Care Costs Recovery Act 2009	Imperial and the UK Companies have all been named as defendants and served.	This case is at an early case management stage. A standstill agreement has been negotiated. Defences were filed in February 2015 and the next step will be document production, which will commence on or before 1 September 2017. Damages have not been quantified by the province. No trial date has been set.
Nova Scotia	Tobacco Health Care Costs Recovery Act 2005	Imperial and the UK Companies have all been named as defendants and served.	This case is at an early case management stage. A standstill agreement has been negotiated. Defences were filed in July 2015 and the next step will be document production, which will commence on or before 1 September 2017. Damages have not been quantified by the province. No trial date has been set.

Nigeria

24. As at 31 December 2016, six medical reimbursement actions filed by the federal government and five Nigerian states (Lagos, Kano, Gombe, Oyo, Ogun) were pending in the Nigerian courts. British American Tobacco (Nigeria) Limited ("BAT Nigeria"), the Company and Investments have been named as defendants in each of the cases. The plaintiffs in the six cases seek a total of approximately £38 billion in damages, including special, anticipatory and punitive damages, restitution and disgorgement of profits, as well as declaratory and injunctive relief.

25. The federal action was filed on 6 November 2007 in the Federal High Court, and the five state actions were commenced in their respective High Courts on 9 May 2007 (Kano), 30 May 2007 (Oyo), 13 March 2008 (Lagos), 17 October 2008 (Gombe), and 28 February 2009 (Ogun). The suits claim that the state and federal government plaintiffs incurred costs related to the treatment of smoking-related illnesses resulting from allegedly tortious conduct by the defendants in the manufacture, marketing, and sale of tobacco products in Nigeria, and assert that the plaintiffs are entitled to reimbursement for such costs. The plaintiffs assert causes of action for negligence, negligent design, fraud and deceit, fraudulent concealment, breach of express and implied warranty, public nuisance, conspiracy, strict liability, indemnity, restitution, unjust enrichment, voluntary assumption of a special undertaking, and performance of another's duty to the public.

26. The Company and Investments have made a number of challenges to the jurisdiction of the Nigerian courts. Such challenges are still pending (on appeal) against the federal government and the states of Lagos, Kano, Gombe and Ogun. In the state of Oyo, on 13 November 2015, the Company's jurisdictional challenge was successful in the Court of Appeal and the issuance of the writ of summons was set aside. The underlying cases are stayed or adjourned pending the final outcome of these jurisdictional challenges.

South Korea

27. In April 2014, Korea's National Health Insurance Service ("NHIS") filed a healthcare recoupment action against KT&G (a Korean tobacco company), PM Korea and BAT Korea (including BAT Korea Manufacturing). The NHIS is seeking damages of roughly 54 billion Korean Won (roughly £37.5 million) in respect of health care costs allegedly incurred by the NHIS treating patients with lung (small cell and squamous cell) and laryngeal (squamous cell) cancer between 2003 and 2012. Court hearings in the case, which constitute the trial, commenced in September 2014 and remain ongoing.

(b) Class actions

Brazil

28. There are currently two class actions being brought in Brazil. One is also a medical reimbursement claim (São Paulo Public Prosecutor's Office), and is therefore discussed above.

29. In 1995, the Associação de Defesa da Saúde do Fumante ("ADESF") class action was filed against Souza Cruz and Philip Morris in the São Paulo Lower Civil Court alleging that the defendants are liable to a class of smokers and former smokers for failing to warn of cigarette addiction. The case was stayed in 2004 pending the defendants' appeal from a decision issued by the Lower Civil Court that held that the defendants had not met their burden of proving that cigarette smoking was not addictive or harmful to health.

30. On 12 November 2008, the São Paulo Court of Appeals overturned the lower court's unfavourable decision of 2004, returning the case to the lower court for production of evidence and a new judgment. Following production of evidence, on 16 May 2011, the lower court granted Souza Cruz's motion to dismiss the action in its entirety on the merits. The plaintiffs' appeal to the São Paulo Court of Appeals was unsuccessful and they have since filed a Special Appeal to the Superior Court of Justice. On 27 November 2015, Souza Cruz filed its response to the appeal, which remains pending.

Canada

31. There are 11 class actions being brought in Canada against Group companies.

32. *Knight Class Action:* The Supreme Court of British Columbia certified a class of all consumers who purchased Imperial cigarettes in British Columbia bearing 'light' or 'mild' descriptors since 1974. The plaintiff is seeking compensation for amounts spent on 'light and mild' products and a disgorgement of profits from Imperial on the basis that the marketing of light and mild cigarettes was deceptive because it conveyed a false and misleading message that those cigarettes are less harmful than regular cigarettes.

33. On appeal, the appellate court confirmed the certification of the class, but limited any financial liability, if proven, to 1997 onward. Imperial's third party claim against the federal government was dismissed by the Supreme Court of Canada. The federal government is seeking a parallel cost order of CAD$5 million from Imperial. After being dormant for several years, the plaintiff delivered a Notice of Intention to Proceed, and Imperial delivered an application to dismiss the action for delay. It is anticipated that a hearing date for the application will be set in June or July of 2017.

34. *Growers' Class Action:* In December 2009, Imperial was served with a proposed class action filed by Ontario tobacco farmers and the Ontario Flue-Cured Tobacco Growers' Marketing Board. The plaintiffs allege that Imperial and the Canadian subsidiaries of Phillip Morris International and Japan Tobacco International failed to pay the agreed domestic contract price to the growers used in products manufactured for the export market and which were ultimately smuggled back into Canada. The plaintiffs seek damages in the amount of CAD$50 million. Various preliminary challenges have been heard, the last being a motion for summary judgment on a limitation period. The motion was dismissed and ultimately, leave to appeal to the Ontario Court of Appeal was dismissed in November 2016. A certification hearing has yet to be scheduled.

35. *Quebec Class Actions:* There are currently two class actions in Quebec. On 21 February 2005, the Quebec Superior Court granted certification in two class actions against Imperial and two other domestic manufacturers, which have a combined value of CAD$21 billion plus interest and costs. The Court certified two classes, which include residents of Quebec who suffered from lung, throat and laryngeal cancer or emphysema as of November 1998 or developed these diseases thereafter and who smoked a minimum of fifteen cigarettes a day for at least five years, and residents who were addicted to nicotine at the time the proceedings were filed and who have since remained addicted. Judgment was rendered on 27 May 2015. The plaintiffs were awarded moral and punitive damages and interest against Imperial and the Canadian subsidiaries of Philip Morris International and Japan Tobacco International in the amount of CAD$15.6 billion, of which Imperial's share is CAD$10.4 billion. An appeal of the judgment was filed on 26 June 2015. The Court also awarded provisional execution pending appeal of CAD$1.131 billion, of which Imperial's share was approximately CAD$742 million. This order was subsequently overturned by the Court of Appeal. Following the cancellation of the order for provisional execution, the plaintiffs filed a motion against Imperial and one other manufacturer seeking security in the amount of CAD$5 billion to guarantee, in whole or in part, the payment of costs of the appeal and the judgment. On 27 October 2015, the Court of Appeal ordered the parties to post security in the amount of CAD$984 million, of which Imperial's share is CAD$758 million to be paid in 7 equal quarterly instalments. The first instalment, of just over CAD$108 million, was paid on 31 December 2015 with subsequent instalments made on 31 March 2016, 30 June 2016, 30 September 2016 and 31 December 2016 — see note 14. Imperial filed its Factum on Appeal on 11 December 2015 and the appeal was heard in November 2016. A decision is under reserve.

36. *Other Canadian Smoking and Health Class Actions:* In June 2009, four new smoking and health class actions were filed in Nova Scotia (Semple), Manitoba (Kunta), Saskatchewan (Adams) and Alberta (Dorion) against Canadian and foreign manufacturers and foreign companies, including the UK Companies and Imperial. In Saskatchewan, the Company and Carreras Rothmans Limited have been released from the action. No date has been set for the certification motion hearing. There are service issues in relation to Imperial and the UK Companies in Alberta and in relation to the UK Companies in Manitoba.

37. In July 2010, two further smoking and health class actions in British Columbia were served on Imperial and the UK Companies. The Bourassa claim is allegedly on behalf of all individuals who have suffered chronic respiratory disease and the McDermid claim proposes a class based on heart disease. Both claims state that they have been brought on behalf of those who have "smoked a minimum of 25,000 cigarettes." The UK Companies and Imperial objected to jurisdiction. Subsequently, the Company and Carreras Rothmans Limited were released from Bourassa and McDermid. Imperial, Industries and Investments remain as defendants in both actions. No certification motion hearing date has been set. The Plaintiffs were due to deliver certification motion materials by 31 January 2015, but have not yet done so. Once the materials are delivered, the motions regarding jurisdiction/abuse of process matters will be dealt with.

38. In June 2012, a new smoking and health class action was filed in Ontario (Jacklin) against the domestic manufacturers and foreign companies, including Imperial and the UK Companies. Imperial was served on 20 November 2012, and the UK Companies were served on 30 November 2012. The claim is presently in abeyance.

Italy

39. In or about June 2010, BAT Italia was served with a class action filed in the Civil Court of Rome by the consumer association, Codacons, and three class representatives. The plaintiffs primarily asserted addiction-related claims. The class action lawsuit was rejected at the first instance (Civil Court of Rome) and appellate (Rome Court of Appeal) court levels. In July 2012, Codacons filed an appeal before the Italian Supreme Court. At a hearing on 21 January 2015, the Public Prosecutor's Office agreed that the appeal should be

rejected, and the Supreme Court reserved its decision. On 1 February 2017, the Supreme Court rejected Codacons' appeal.

Venezuela

40. In April 2008, the Venezuelan Federation of Associations of Users and Consumers (FEVACU) and Wolfang Cardozo Espinel and Giorgio Di Muro Di Nunno, acting as individuals, filed a class action against the Venezuelan Government. The class action seeks regulatory controls on tobacco and recovery of medical expenses for future expenses of treating smoking-related illnesses in Venezuela. Both C.A Cigarrera Bigott Sucs. ("Cigarrera Bigott") and ASUELECTRIC, represented by its president Giorgio Di Muro Di Nunno (who had previously filed as an individual), have been admitted as third parties by the Constitutional Chamber of the Supreme Court of Justice. A hearing date for the action is yet to be scheduled.

(c) Individual personal injury claims

41. As at 31 December 2016, the jurisdictions with the most active individual cases against Group companies were, in descending order: Brazil (81), Italy (23), Chile (10), Argentina (8), Canada (6) and Ireland (2). There were a further three jurisdictions with one active case only.

Non-Tobacco Related Litigation

Reynolds American, Inc./Lorillard, Inc. Shareholder Litigation

42. On 15 July 2014, Reynolds American, Inc. ("Reynolds") announced that it had entered into a definitive merger agreement with Lorillard, Inc. ("Lorillard"), whereby Reynolds would acquire Lorillard in exchange for a combination of cash and Reynolds' stock (the "Lorillard Transaction"). As part of this transaction, the Company executed a Share Purchase Agreement to acquire a sufficient number of Reynolds' shares to maintain its 42% equity stake in Reynolds after the merger.

43. On 8 August 2014, the Company was named as a defendant in an action in state court in North Carolina stemming from the announcement of the Lorillard Transaction. The action was brought on behalf of a putative class of Reynolds' shareholders alleging that the Company is a controlling shareholder of Reynolds and breached its fiduciary duty to the other Reynolds' shareholders in connection with the Lorillard Transaction.

44. On 28 August 2015, the court dismissed all claims against the Company. Among other things, the court found that the plaintiff had not properly alleged that the Company was a controlling shareholder of Reynolds and therefore that the Company did not owe a fiduciary duty to Reynolds' other shareholders. On 20 December 2016, the North Carolina Court of Appeals reversed the trial court's judgment with respect to the claims against the Company, finding the allegations that the Company was a controlling shareholder and breached its fiduciary duty to be sufficient to warrant further proceedings for the plaintiff to attempt to prove those allegations with evidence. On 4 January 2017, the Company moved to have the North Carolina Court of Appeals rehear the case en banc, and that motion was denied on 2 February 2017. On 17 February 2017, the Company filed a petition for discretionary review with the North Carolina Supreme Court.

Khosravi

45. In January 2014 an individual named Mehdi Khosravi issued a claim in the English High Court against the Company, as well as Al Aqili Trading LLC, Mohammed Saleh Al Aqili and Mohammed Saeed Mohamed Al Aqili (the "Al Aqili Defendants"). In September 2015 the claimant amended his claim to join B.A.T (U.K. and Export) Limited and B.A.T. Pars Company as defendants and served the claim on the Company and B.A.T (U.K. and Export) Limited (the "BAT UK Defendants"). B.A.T. Pars Company has not been served with the claim and therefore is currently not an active party to the proceedings.

46. The claimant sought damages of up to £1.5 billion for alleged personal injuries and economic loss which, he alleged, were caused by the Al Aqili Defendants acting as agents for the BAT UK Defendants and/or for which the BAT UK Defendants were vicariously liable. On 28 January 2016, the judge dismissed the case against the BAT UK Defendants and ordered that the claimant should pay their legal costs. The claimant then applied for permission to appeal the decision. Permission to appeal was refused on paper on 22 November 2016, but the claimant is entitled to a hearing to consider his application. The hearing is scheduled for 4 July 2017.

Georgian Competition Claim

47. In July 2016 OGT Ltd ("OGT"), a Georgian tobacco manufacturer, filed a claim in the Tbilisi City Court against British American Tobacco Georgia Limited ("BAT Georgia") and BAT Georgia's Representative Office in Tbilisi, as well as T&R Distribution Ltd, BAT Georgia's exclusive distributor in Georgia alleging anti-competitive practices on behalf of the defendants. In January 2017, OGT filed a revised pleading claiming damages of approximately US$101 million. BAT Georgia and its Representative Office filed their revised defence again denying the allegations and a counterclaim in January 2017. On 10 February 2017 judgment was entered against BAT Georgia for US$100,537,172, BAT Georgia's counterclaim was dismissed and the Georgian court ordered that it would determine the price at which BAT Georgia's brands would be sold. The judgment will be appealed.

Fox River

Background to environmental liabilities arising out of contamination of the Fox River

48. In Wisconsin, the authorities have identified potentially responsible parties ("PRPs") to fund the clean-up of river sediments in the lower Fox River. The pollution was caused by discharges of Polychlorinated Biphenyls ("PCBs") from paper mills and other facilities operating close to the river. Among the PRPs is NCR Corporation ("NCR").
49. In NCR's Form 10-K Annual Report for the year ended 31 December 2014, the total clean-up costs for the Fox River are estimated at US$825 million. This estimate is subject to uncertainties and does not include natural resource damages ("NRDs"). Total NRDs may range from US$0 to US$246 million, although NCR now only retains residual exposure to NRDs in the form of claims by other PRPs as the US Government has withdrawn its direct claims for NRDs against NCR.
50. Industries' involvement with the environmental liabilities arises out of indemnity arrangements which it became party to due to a series of transactions that took place from the late-1970s onwards and subsequent litigation brought by NCR against Industries and Appvion Inc ("Appvion") (a former Group subsidiary) in relation to those arrangements which was ultimately settled. US authorities have never identified Industries as a PRP.
51. There has been a substantial amount of litigation in the United States involving NCR and Appvion regarding the responsibility for the costs of the clean-up operations. The current position can be summarised as follows:
    (a) As regards the upper portion of the Fox River, the District Court has ruled that NCR is liable in respect of this portion of the river because the river constitutes one site. That notwithstanding, the District Court has since indicated that NCR had no liability for that portion of the river because it did not discharge PCBs there.
    (b) As regards the mid and lower portions of the Fox River:
        I. As a result of the US Government enforcement proceedings against it, NCR has been held jointly and severally liable in respect of the mid and lower portions of the Fox River. Consequently, NCR is responsible for the costs of cleaning-up of the mid and lower portions of the river, subject to any right of contribution it has against other PRPs and any right to appeal.
        II. Appvion on the other hand has been found not liable in respect of the clean-up (including NRDs) in the US Government enforcement proceedings.
        III. The remaining element of the US Government enforcement proceedings (the US Government's claim against NCR to recover costs it has incurred in relation to the clean-up) was scheduled to go to trial in May 2017 but those proceedings have now been stayed (as explained below).
        IV. NCR's claims for contribution against the other PRPs in respect of the costs it has incurred in relation to the clean-up (and those PRPs' cross claims for contribution against NCR to recover the costs they have incurred and NRDs they have had to pay) were scheduled to go to trial in May 2017 but those proceedings have also been stayed (as explained below).
        V. Appvion's claims to recover from PRPs other than NCR monies that it spent on the clean-up prior to being held not liable were also due to go to trial at the same time but have been stayed as well.

Recent settlements

52. On 22 December 2016, NCR and Appvion entered into a settlement agreement with certain of the other PRPs pursuant to which those PRPs released their contribution claims against NCR and Appvion released its claims against those PRPs. The provision has been updated accordingly.
53. On 17 January 2017, NCR and Appvion entered into a Consent Decree (a form of settlement agreement) with the US Government to resolve how the remaining clean-up will be funded and to resolve all outstanding claims between them.
54. The Consent Decree requires approval from the District Court in Wisconsin in order to be made final. The public has 30 days (until 22 February 2017) to comment on the proposal, after which the Court will make a determination. It is anticipated that the Court approval process will take several months. The US Government enforcement action and the PRPs' contribution claims have been stayed pending the outcome of the Court approval process.
55. If the Consent Decree is approved its principal effects will, in summary, be as follows:
    (a) NCR will perform and fund all of the remaining Fox River remediation work by itself.
    (b) The US Government enforcement proceedings will be settled, with NCR having no liability to meet the US Government's claim for costs it has incurred in relation to the clean-up to date and only a secondary responsibility to meet certain future costs. NCR will have no liability to the US Government for NRDs.
    (c) NCR will cease to pursue its contribution claims against the other PRPs and in return will receive contribution protection which means that the other PRPs will not be able to pursue their contribution claims against NCR. NCR will, however, have the right to reinstate its contribution claims if the other PRPs decide to continue to pursue certain contractual claims against NCR.
    (d) Appvion will also cease to pursue its claims against the other PRPs to recover monies that it has spent on the clean-up and in return will receive contribution protection. Appvion will, however, have the right to reinstate its claims if the other PRPs decide to continue to pursue certain claims against Appvion.

Industries' involvement with environmental liabilities arising out of the contamination of the Fox River

56. NCR has taken the position that, under the terms of a 1998 Settlement Agreement between it, Appvion and Industries and a 2005 arbitration award, Industries and Appvion generally had a joint and several obligation to bear 60% of the Fox River environmental remediation costs imposed on NCR and of any amounts NCR has to pay in respect of other PRPs' contribution claims.
57. Until May 2012, Appvion and the AWA Entities paid the 60% share of the clean-up costs and Industries was never required to contribute. Around that time Appvion refused to continue to pay clean-up costs, leading to NCR demanding that Industries pay a 60% share.
58. Industries commenced proceedings against Windward and Appvion in December 2011 seeking indemnification in respect of any liability it might have to NCR (the "English Indemnity Proceedings") pursuant to a 1990 de-merger agreement between those parties.

Funding Agreement of 30 September 2014

59. On 30 September 2014, Industries entered into the Funding Agreement with Windward, Appvion, NCR and BTI 2014 LLC ("BTI") (a wholly owned subsidiary of Industries). Pursuant to the Funding Agreement, the English Indemnity Proceedings and a counterclaim Appvion had brought in those proceedings, as well as an NCR-Appvion arbitration concerning Appvion's indemnity to NCR, were discontinued as part of an overall agreement between the parties providing a framework through which they would together fund the ongoing costs of the Fox River clean-up. Under the agreement, NCR has agreed to accept funding by Industries at the lower level of 50% of the ongoing clean-up related costs of the Fox River (rather than the 60% referenced above; this remains subject to an ability to litigate the extent to which a further 10% of the costs ought to be allocated at a later stage). In addition Windward has contributed US$10 million of funding and Appvion has contributed US$25 million for Fox River and agreed to contribute US$25 million for the Kalamazoo River (see further below).

60. The parties also agreed to cooperate in order to maximise recoveries from certain claims made against third parties, including (i) a claim commenced by Windward in the High Court of England & Wales (the High Court) against Sequana and the former Windward directors (the “Windward Dividend Claim”). That claim was assigned to BTI under the Funding Agreement, and relates to dividend payments made by Windward to Sequana of around €443 million in 2008 and €135 million in 2009 (the “Dividend Payments”) and (ii) a claim commenced by Industries directly against Sequana to recover the value of the Dividend Payments alleging that the dividends were paid for the purpose of putting assets beyond the reach of Windward’s creditors (including Industries) (the “BAT section 423 Claim”).

61. A trial of the Windward Dividend Claim and the BAT section 423 Claim took place before the English High Court between February and April 2016. Judgment was handed down by the High Court on 11 July 2016. The Court held that the 2009 Dividend Payment of €135 million was a transaction at an undervalue made with the intention of putting assets beyond the reach of Industries or of otherwise prejudicing Industries’ interests. It therefore contravened Section 423 of the Insolvency Act. The Court dismissed the Windward Dividend Claim. BTI sought permission to appeal in respect of the Judge’s findings in relation to the Windward Dividend Claim. Sequana sought permission to appeal the Judge’s findings in relation to the BAT section 423 Claim.

62. On 13 and 16 January 2017 and 3 February 2017 further hearings took place to determine the precise form of relief to be awarded to Industries and to hear the parties’ applications for permission to appeal. Judgment was handed down on 10 February 2017. In respect of relief, the Court ordered that Sequana must pay BTI an amount up to the full value of the 2009 Dividend plus interest (which equates to around US$185 million). This figure is subject to increase as interest is continuing to accrue. Sequana must make an initial payment of around US$138.4 million and further payments going forward as and when Industries makes payments in respect of clean-up costs. In respect of appeals, the Court granted BTI and Sequana permission to appeal. The appeal hearing is expected to take place during 2018. The Court also granted Sequana a stay in respect of the above payments it has been ordered to make pending Sequana’s appeal being resolved.

63. BTI has brought claims against certain of Windward’s former advisers, including Windward’s auditors at the time of the dividend payments, PricewaterhouseCoopers LLP (which claims were also assigned to BTI under the Funding Agreement). Those claims are currently subject to a stay.

64. The sums Industries has agreed to pay under the Funding Agreement are subject to ongoing adjustment, as clean-up costs can only be estimated in advance of the work being carried out and as certain sums payable are the subject of ongoing US litigation. In 2016, Industries paid £6 million in respect of clean-up costs and is potentially liable for a further £159 million in future clean-up costs. Industries has a provision of £163 million which represents the current best estimate of its exposure — see note 21.

Kalamazoo

65. Industries is aware that NCR is also being pursued by Georgia-Pacific, as the owner of a facility on the Kalamazoo River in Michigan which released PCBs into that river. Georgia-Pacific has been designated as a PRP in respect of the river.

66. Georgia-Pacific contends that NCR is responsible for, or should contribute to, the clean-up costs, because:

    (a) a predecessor to NCR’s Appleton Papers Division sold “broke” containing PCBs to Georgia-Pacific or others for recycling;

    (b) NCR itself sold paper containing PCBs to Georgia-Pacific or others for recycling; and/or

    (c) 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.

67. A full trial on liability took place in February 2013. On 26 September 2013, the Michigan Court held that NCR was liable as a PRP on the basis that broke sales constituted an arrangement for the disposal of hazardous material for the purposes of CERCLA. The decision was based on NCR’s knowledge of the hazards of PCBs from at least 1969, but the Court did not specify directly the entity(ies) whose broke sales form the basis of NCR’s liability. NCR will have the ability to appeal the ruling once a final judgment has been entered or it has been otherwise certified for appeal.

68. The second phase of the Kalamazoo trial to determine the apportionment of liability amongst NCR, Georgia-Pacific and the other PRPs (International Paper Company and Weyerhaeuser Company) took place between

September and December 2015. The parties are currently waiting for the Court to hand down its judgment. The court may or may not also rule on the allocation of future costs. Industries anticipates that NCR may seek to recover from Appvion (subject to a cap of US$25 million for "Future Sites" under the Funding Agreement as described above) and/ or Industries 60% of any Kalamazoo clean-up costs for which it is found liable on the basis, it would be asserted, that the river constitutes a "Future Site" for the purposes of the Settlement Agreement. Industries believes it may have defences to any such claim by NCR. The Funding Agreement described above does not resolve any such claims, but does provide an agreed mechanism pursuant to which any surplus from the valuable recoveries of any third party claims that remains after all Fox River related clean-up costs have been paid and Industries and NCR have been made whole may be applied towards Kalamazoo clean-up costs, in the event that NCR were to be successful in any claim for a portion of them from Industries or Appvion (subject to Appvion's cap). The quantum of the clean-up costs for the Kalamazoo River is presently unclear (as is the extent of NCR's liability in respect of such costs), but could run into the hundreds of millions of dollars. A witness on behalf of Georgia-Pacific testified in the trial concerning apportionment of liability that the cost of performing future remediation in Operable Unit 5 of the Kalamazoo River was in the order of US$670 million. Operable Unit 5 is the Kalamazoo River itself, as distinct from the other Operable Units which are landfills or other facilities adjoining the Kalamazoo River. Remediation of these other Operable Units has largely been completed except for monitoring.

69. As detailed above, Industries is taking active steps to protect its interests, including seeking to procure the repayment of the Windward dividends, pursuing the other valuable claims that are now within its control, and working with the other parties to the Funding Agreement to maximise recoveries from third parties with a view to ensuring that amounts funded towards clean-up related costs are later recouped under the agreed repayment mechanisms.

General Litigation Conclusion

70. 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. An adverse judgment was entered against one Group company, Imperial, in the Quebec class actions and an appeal has been made. If further adverse judgments are entered against any of the Group's companies in any case, all avenues of appeal will be pursued. Such appeals could require the appellants to post appeal bonds or substitute security (as has been necessary in Quebec) in amounts which could in some cases equal or exceed the amount of the judgment. In any event, as set out in paragraphs 5 to 9, the Group has the benefit of the RJRT Indemnification with regard to US litigation (excluding the litigation brought by the shareholders of Reynolds). 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.

71. Having regard to all these matters, with the exception of Fox River, the Group (i) does not consider it appropriate to make any provision in respect of any pending litigation; and (ii) does not believe that the ultimate outcome of this litigation will significantly impair the Group's financial condition.

Tax Disputes

The Group has exposures in respect of the payment or recovery of a 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 Group's accounting policies. In some countries, tax law requires that full or part payment of disputed tax assessments be made pending resolution of the dispute. To the extent that such payments exceed the estimated obligation, they would not be recognised as an expense.

The following matters may proceed to litigation:

Brazil

The Brazilian Federal Tax Authority has filed claims against Souza Cruz seeking to reassess the profits of overseas subsidiaries to corporate income tax and social contribution tax. The reassessments are for the years 2004 until and including 2012 for a total amount of R$1,386 million (£345 million) to cover tax, interest and penalties. The 2011 and 2012 reassessments were raised in December 2016.

Souza Cruz appealed all reassessments. Regarding the first assessments (2004-2006) Souza Cruz appeal was rejected in 2013 although the written judgment of that tribunal was received in 2016. Souza Cruz have appealed the decision. The appeal against the second assessments (2007 and 2008) was upheld at the second tier tribunal and was closed. In 2015 a further reassessment for the same period (2007 and 2008) was raised after the 5 year statute of limitation. This has been appealed to the administrative level special chamber.

Souza Cruz received further reassessments in 2014 for the 2009 calendar year and in 2015 an assessment for the 2010 calendar year. Souza Cruz appealed both the reassessments in full. In December 2016, assessments were received for the calendar years 2011 and 2012 which have also been appealed.

South Africa

In 2011 the South African Revenue Service ("SARS") challenged the debt financing of British American Tobacco South Africa ("BATSA") and reassessed the years 2006 to 2008. BATSA has objected to and appealed this reassessment. In 2014, SARS also reassessed the years 2009 and 2010. In 2015, BATSA has filed formal Notices of Appeal and detailed objection letters against the 2009 and 2010 assessments and has reserved its right to challenge the constitutionality of the assessment at a later date. In 2016, SARS has filed a Statement of Grounds of Assessment and BATSA is due to file its Statement of Grounds of Appeal in early 2017. Across the period from 2006 to 2010 the reassessments are for R1.92 billion (£112 million) covering both tax and interest.

Netherlands

The Dutch tax authority has issued assessments for the years 2008, 2009, 2011 and 2012 in the sum of €202 million (£172 million) to cover tax, interest and penalties. The assessments relate to a number of inter group transactions. Objection letters have been filed against the 2008, 2009, 2011 and 2012 assessments.

The Group believes that the Group's companies have meritorious defences in law and fact in each of the above matters and intends to pursue each dispute through the judicial system as necessary. The Group does not consider it appropriate to make provision for these amounts assessed nor for any potential further amounts which may be assessed in subsequent years.

While the amounts that may be payable or receivable in relation to tax disputes could be material to the results or cash flows of the Group in the period in which they are recognised, the Board does not expect these amounts to have a material effect on the Group's financial condition.

VAT and Duty Disputes

Bangladesh

The operating company is in receipt of a retrospective notice of imposition and realisation of VAT and supplementary duty on low price category brands from the National Board of Revenue ("NBR") for approximately £186 million. The company is alleged to have evaded tax by selling the products in the low price segments rather than the mid-tier price segments. Management believe that the claims are unfounded. Litigation has proceeded during 2016. The issue is currently awaiting outcome from the Supreme Court, and a 10% deposit may have to be paid during 2017 in order to pursue any appeal.

Operating leases

Total future minimum lease payments under non-cancellable operating leases comprise leases where payments fall due:

	2016 £m	2015 £m
Property		
Within one year	**45**	51
Between one and five years	**104**	102
Beyond five years	**50**	48
	199	201
Plant and equipment		
Within one year	**18**	19
Between one and five years	**23**	26
	41	45

Performance guarantees

As shown in note 24, as part of the acquisition of TDR in 2015, the Group has committed to keeping the manufacturing facility in Kanfanar, Croatia operational for at least five years following completion of the acquisition. A similar commitment was given in respect of the packaging plant in Rovinj, Croatia. The maximum exposure under these guarantees is £42 million (2015: £38 million).

29 Interests in subsidiaries

Subsidiaries with material non-controlling interests

Non-controlling interests principally arise from the Group's listed investment in Malaysia (British American Tobacco (Malaysia) Berhad) (where the Group held 50% of the listed holding company in both 2016 and 2015). The Group has assessed that it exercises de facto control over Malaysia as it has the practical ability to direct the business through effective control of the company's board as a result of the Group controlling the largest shareholding block in comparison to other shareholdings which are widely dispersed. Summarised financial information for Malaysia is shown below as required by IFRS 12. As part of the Group's reporting processes, Malaysia report consolidated financial information for the Malaysia group which has been adjusted to comply with Group accounting policies which may differ to local accounting practice. Goodwill in respect of Malaysia, which arose as a result of the acquisition of the Rothmans group referred to in note 9, has not been included as part of the net assets below. No adjustments have been made to the information below for the elimination of intercompany transactions and balances with the rest of the Group.

Summarised financial information	Malaysia Group	
	2016	2015
	£m	£m
Revenue	**334**	422
Profit for the year	**129**	152
- Attributable to non-controlling interests	***64***	*76*
Total comprehensive income	**146**	136
- Attributable to non-controlling interests	***73***	*68*
Dividends paid to non-controlling interests	**(59)**	(75)
Summary Net Assets:		
Non-current assets	**31**	43
Current assets	**103**	74
Non-current liabilities	**(4)**	(8)
Current liabilities	**(94)**	(99)
Total equity at the end of the year	**36**	10
- Attributable to non-controlling interests	***18***	*5*
Net cash generated from operating activities	**108**	164
Net cash generated in investing activities	**45**	1
Net cash used in financing activities	**(151)**	(161)
Differences on exchange	**1**	—
Increase in net cash and cash equivalents	**3**	4
Net cash and cash equivalents at 1 January	**5**	1
Net cash and cash equivalents at 31 December	**8**	5

Other shareholdings

In the section 'Group Companies and Undertakings' on pages 153 to 161, the Group discloses the effective percentage of equity shares held in subsidiary and other undertakings.

The Group holds 92% (2015: 85%) of the equity shares of PT Bentoel Internasional Investama Tbk ("Bentoel"). In 2011, the Group sold 984 million shares, representing approximately 14% of Bentoel's share capital, for the purposes of fulfilling certain obligations pursuant to Bapepam LK (Indonesia) takeover regulations. The Group simultaneously entered into a total return swap on 971 million of the shares. In June 2016, the Group and other investors participated in a rights issue by Bentoel, increasing its stake in Bentoel to 92%. Simultaneously, the Group amended the total return swap to take account of an addition 1,684 million shares. The shares subject to the total return swap now represent 7% of Bentoel's issued capital. While the Group does not have legal ownership of these shares, it retains the risks and rewards associated with them which results in the Group continuing to recognise an effective interest in 99% of Bentoel's net assets and results.

The Group holds 42% (2015: 26%) of the equity shares of Tisak d.d. ("Tisak"). During 2016, the Group entered into an agreement with Tisak's parent Agrokor d.d. ("Agrokor") to convert certain outstanding trading balances into long term loans and an additional shareholding in Tisak. As part of the agreement, Agrokor has the right to reacquire the additional shareholding in Tisak. As a consequence of this, while the Group has legal ownership of the additional shareholding, it does not consider the shares to provide any additional equity interest and continues to account for 26% of the equity of Tisak.

30 Post balance sheet date announcement

On 17 January 2017, the Group announced the agreed terms of a recommended offer for the acquisition of the remaining 57.8% of Reynolds American Inc. Reynolds American not already owned by the Group. Reynolds American shareholders will receive for each Reynolds share US$29.44 in cash and 0.5260 BAT ordinary shares which shall be represented by BAT American Depositary Receipts ("ADRs") listed on the New York Stock Exchange ("NYSE").

The parties expect the transaction to close during the third quarter of 2017, subject to: obtaining affirmative votes from BAT and Reynolds American shareholders; obtaining anti-trust approvals in the US and Japan; registration of BAT shares with the SEC; approval of the BAT shares for listing on the LSE and the BAT ADRs on the NYSE; and, other customary conditions. The completion of the merger is not subject to any financing condition.

As disclosed in note 28, on 10 February 2017, judgment was entered against the Group for US$101 million in respect of alleged anti-competitive practices in Georgia. The judgment will be appealed.

Independent auditor's report
To the members of British American Tobacco p.l.c. only

Opinions and conclusions arising from our audit

1 Our opinion on the Group financial statements is unmodified

We have audited the Group financial statements of British American Tobacco p.l.c. for the year ended 31 December 2015 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 and the related notes. 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 2015 and of its profit for the year then ended;
- have been properly prepared in accordance with International Financial Reporting Standards 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.

Certain required disclosures have been presented elsewhere in the Annual Report, rather than in the notes to the accounts. These are cross-referenced from the Group financial statements and identified as audited.

2 Our assessment of risks of material misstatement

In arriving at our audit opinion above on the Group financial statements, the risks of material misstatement that had the greatest effect on our audit were as follows:

Provisions and contingent liabilities in respect of litigations

Refer to page 59 (Audit Committee Report), page 135 (accounting policy note) and pages 178, 192–201 (financial disclosures)

The risk: The Group is subject to claims and class actions, which could have a significant impact on the Group's results if the potential exposures were to materialise. Management applies significant judgement when considering whether, and how much, to provide for the potential exposure of each litigation. We focused on this area given the number and magnitude of potential exposures across the Group, and the complexity and judgement necessary to determine whether to provide for or disclose certain exposures.

Our response: Our procedures included an assessment of the processes and controls over litigations operated by Management at a Group, regional and local level. We met quarterly with the Group's in-house legal counsel including after the year end to discuss the nature of ongoing claims, and to validate the latest status and accounting and disclosure implications. Our in-scope component audit teams reported to us on the status of open claims, and helped us to validate completeness of the matters discussed by us at a Group level. We also obtained formal confirmations from the Group's external counsel for significant litigation matters to ensure completeness of provisioning and disclosure. We assessed relevant historical and recent judgments passed by the court authorities alongside legal opinion from external lawyers to challenge the basis used for the provisions recorded or disclosures made by Management. Where provisions were not required, we also considered the adequacy and completeness of the Group's disclosures in note 30 made in relation to contingent liabilities.

IT system change (TaO)

Refer to page 59 (Audit Committee Report)

The risk: The Group has continued to implement its revised Operating Model and single IT operating system in a number of end markets over the course of the year. An IT migration project of this type presents inherent risks including the loss of integrity of key financial data being migrated, and the breakdown in operation or monitoring of IT dependent controls within critical business processes (purchase to pay, order to cash, and record to report), which could lead to financial errors or misstatements and inaccurate financial reporting.

Our response: Our procedures included use of our IT specialists to assess and test the General IT control environment of the single IT operating system, including IT access and segregation of duties, as well as IT dependent controls within critical business processes. In relation to the system migration itself, our IT specialists assessed and tested the controls specifically established over the implementation process and migration of key financial data from the legacy to the new single operating system, and reviewed the work of Internal Audit and other external specialists to corroborate our findings. Additionally, where system migration

occurred during 2015, our end market component audit teams performed independent validation of the data migration and reconciliation between legacy systems and the single IT operating system.

Global taxation exposures

Refer to page 59 (Audit Committee Report), page 133 (accounting policy note) and pages 145–146, 160–161, 201–202 (financial disclosures)

The risk: The Group operates in multiple jurisdictions governed by national tax laws and regulations and is required to estimate the tax effect of cross-border transactions including transfer pricing arrangements. Where the precise impact of these laws and regulations on indirect taxes and the tax payable on profits is unclear, the Group seeks to make reasonable estimates to determine the tax charge arising. The calculation of the amount of tax receivable or payable, in addition to any specific taxation provisions that are required, is often complex, and requires a significant level of expertise and judgement.

Our response: Our audit procedures included the use of our own international and local tax specialists to assess the Group's tax positions, its correspondence with the relevant tax authorities, and to analyse and challenge the assumptions used to determine tax provisions based on our knowledge and experience of the application of the international and local legislation by the relevant authorities and courts. We also considered the adequacy of the Group's disclosures in respect of tax and uncertain tax positions.

Goodwill and intangible asset impairment

Refer to page 133 (accounting policy note) and pages 149–150 (financial disclosures)

The risk: As at 31 December 2015, the Group had £9,324 million of goodwill and £583 million of trademarks and similar intangibles, principally relating to the acquisitions of, among others, Rothmans, Imperial Tobacco Canada, ETI (Italy), ST (Scandinavia) and Bentoel (Indonesia). There is significant judgement involved in forecasting and discounting of future cash flows, which is the basis of the assessment of the recoverability of goodwill balances.

Our response: In this area our audit procedures included testing of the Group's budgeting procedures upon which the forecasts are based and the integrity of the Group's discounted cash flow model. We used our own valuation specialists to assist us in evaluating the assumptions and methodologies used by the Group, in particular those relating to the Group and cash-generating unit level discount rates. Where required, we compared the Group's assumptions to externally derived data as well as our own assessments in relation to key inputs such as projected growth, volumes, market share and competition, cost inflation and discount rates, as well as performing break-even analysis on the assumptions. We also assessed whether the Group's disclosures about the sensitivity of the outcome of the impairment assessment to changes in key assumptions reflected the risks inherent in the valuation of goodwill.

3 Our application of materiality and an overview of the scope of our audit

Materiality

The materiality for the Group financial statements as a whole was set at £245 million, determined with reference to a benchmark of Group profit before taxation adjusted to exclude:

- a current year one-off gain in relation to the investment to maintain a 42% shareholding in Reynolds American Inc. (RAI) of £601 million as disclosed in note 4; and
- a current year one-off gain in relation to the Group's share of divestiture of assets recorded in RAI following the Lorillard acquisition of £371 million as disclosed in note 5.

This represents 5.0% of the Group's reported profit before taxation as adjusted.

We report to the Audit Committee any corrected or uncorrected identified misstatements exceeding £12 million, in addition to other identified misstatements that warranted reporting on qualitative grounds.

Scope of our audit

In establishing the overall approach to our audit, we considered the centralised nature of the Group's operations, the risk profile of countries where the Group operates, and changes taking place within the business. We also considered the financial significance of each business unit together with any local statutory audit requirements.

The Group financial statements are a consolidation of over 300 end market and corporate reporting components, primarily structured across four geographic regions, being Asia-Pacific; Americas; Western Europe; and Eastern Europe, Middle East and Africa. The Group has four centralised shared service centres that perform accounting and reporting activities, and together these shared service centres process a substantial portion of the Group's transactions. The outputs from the centralised shared service centres are included in the financial information of the end market entities they serve.

Each of the shared service centres was subject to specified audit procedures, primarily to test the effectiveness of the financial controls that they operate.

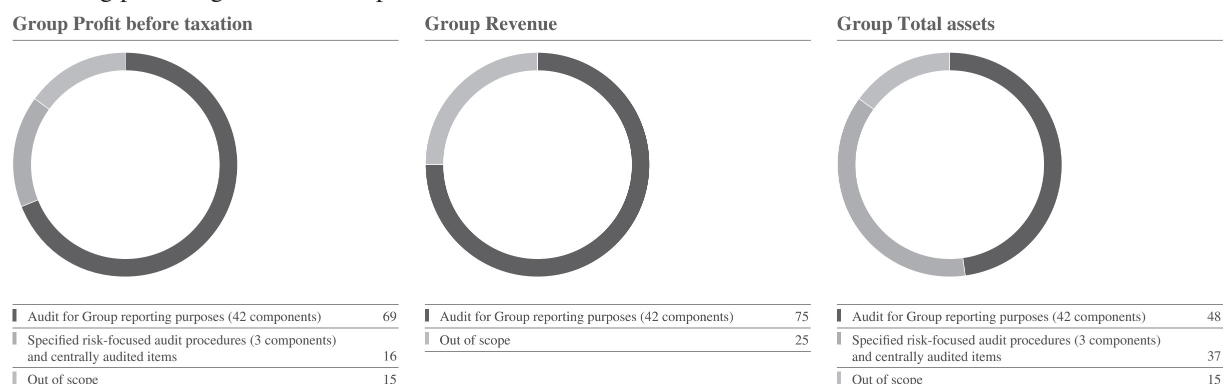
For Group reporting purposes, we determined that 42 end market components required audits performed under our instruction. Audits of these components were performed using materiality levels assigned by the Group audit team, which were lower than the materiality level for the Group as a whole, ranging from £2 million to £70 million, and determined by reference to the size and risk profile of the components. Specified risk-focused audit procedures were performed by Group and component auditors on certain balances and transactions in respect of a further three end market components, one of which is an associate.

The Group consolidation, financial statement disclosures and a number of complex items were audited by the Group engagement team centrally in London. These included general IT controls, taxation, pensions, litigation, treasury, goodwill and intangible asset impairment, and earnings per share.

Detailed audit instructions were sent to all auditors of in-scope components. These instructions covered the significant audit areas that we required to be covered by these audits (which included the relevant risks of material misstatement detailed above) and set out the information required to be reported back to the Group audit team.

The Group audit team visited component locations subject to audit in Brazil, Canada, Russia, South Africa, Turkey, UAE, Australia, Indonesia, Japan, Malaysia, Denmark, Germany, Italy and Romania, as well as shared service centres in Romania, Malaysia and Costa Rica. The Group team also held regional meetings with component teams subject to both audit and specified risk-focused audit procedures as part of the audit planning phase to explain our audit instructions and discuss the component auditors' audit plans. In addition to these visits, telephone and/or online meetings were held with component auditors. The findings reported to the Group audit team were discussed in more detail with component auditors as necessary, and any further work required by the Group audit team was then performed by the component auditor.

Taken together, the end market components and Group functions in the scope of our work accounted for the following percentages of the Group's results:



Group Profit before taxation

Audit for Group reporting purposes (42 components)	69
Specified risk-focused audit procedures (3 components) and centrally audited items	16
Out of scope	15

Group Revenue

Audit for Group reporting purposes (42 components)	75
Out of scope	25

Group Total assets

Audit for Group reporting purposes (42 components)	48
Specified risk-focused audit procedures (3 components) and centrally audited items	37
Out of scope	15

For the remaining components, we performed analysis at an aggregated Group level to re-examine our assessment that there were no significant risks of material misstatement within these.

4 Our opinion on other matters prescribed by the Companies Act 2006 is unmodified

In our opinion the information given in the Strategic Report and the Directors' Report for the financial year for which the financial statements are prepared is consistent with the Group financial statements.

5 We have nothing to report on the disclosures of principal risks

Based on the knowledge we acquired during our audit, we have nothing material to add or draw attention to in relation to:

- the Directors' statement of viability on page 38, concerning the principal risks, their management and, based on that, the Directors' assessment and expectations of the Group's continuing in operation over the three years to 2018; or
- the disclosures in page 35 of the financial statements concerning the use of the going concern basis of accounting.

6 We have nothing to report in respect of the matters on which we are required to report by exception

Under ISAs (UK and Ireland) we are required to report to you if, based on the knowledge we acquired during our audit, we have identified other information in the Annual Report that contains a material inconsistency with either that knowledge or the financial statements, a material misstatement of fact, or that is otherwise misleading.

In particular, we are required to report to you if:

- we have identified material inconsistencies between the knowledge we acquired during our audit and the Directors' statement that they consider that the Annual Report and financial statements taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's position and performance, business model and strategy; or
- the section of the Annual Report on page 58 describing the work of the Audit Committee does not appropriately address matters communicated by us to the Audit Committee.

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' statements, set out on pages 35 and 38, in relation to going concern and longer-term viability; and
- the part of the Corporate Governance Statement on page 46 relating to the company's compliance with the 11 provisions of the 2014 UK Corporate Governance Code specified for our review.

We have nothing to report in respect of the above responsibilities.

7 Other matter — we have reported separately on the parent company financial statements

We have reported separately on the parent company financial statements of British American Tobacco p.l.c. for the year ended 31 December 2015 and on the information in the Directors' Remuneration Report that is described as having been audited.

Scope and responsibilities

As explained more fully in the Directors' Responsibilities Statement set out on page 120, the Directors are responsible for the preparation of the Group financial statements and for being satisfied that they give a true and fair view. A description of the scope of an audit of financial statements is provided on the Financial Reporting Council's website at www.frc.org.uk/auditscopeukprivate. This report is made solely to the company's members as a body and is subject to important explanations and disclaimers regarding our responsibilities, published on our website at www.kpmg.com/uk/auditscopeukco2014a, which are incorporated into this report as if set out in full and should be read to provide an understanding of the purpose of this report, the work we have undertaken and the basis of our opinions.

Mark Baillache (Senior Statutory Auditor)
for and on behalf of KPMG LLP, Statutory Auditor
Chartered Accountants
15 Canada Square
London, E14 5GL

24 February 2016

Group Income Statement
For the year ended 31 December

	Notes	2015	2014
		£m	£m
Gross turnover (including duty, excise and other taxes of £27,896 million (2014: £28,535 million))		**41,000**	42,506
Revenue	2	**13,104**	13,971
Raw materials and consumables used		**(3,217)**	(3,088)
Changes in inventories of finished goods and work in progress		**184**	58
Employee benefit costs	3(a)	**(2,039)**	(2,194)
Depreciation, amortisation and impairment costs	3(b)	**(428)**	(523)
Other operating income	3(c)	**225**	178
Other operating expenses	3(d)	**(3,272)**	(3,856)
Profit from operations	2	**4,557**	4,546
Analysed as:			
- adjusted profit from operations	2	**4,992**	5,403
- restructuring and integration costs	3(e)	**(367)**	(452)
- amortisation of trademarks and similar intangibles	3(f)	**(65)**	(58)
- Fox River	3(g)	**—**	27
- Flintkote	3(h)	**(3)**	(374)
		4,557	4,546
Net finance income/(costs)	4	**62**	(417)
Finance income		**646**	67
Finance costs		**(584)**	(484)
Share of post-tax results of associates and joint ventures	5	**1,236**	719
Analysed as:			
- adjusted share of post-tax results of associates and joint ventures	2	**943**	712
- issue of shares and change in shareholding	5	**22**	14
- gain on disposal of assets	5	**371**	—
- other	5	**(100)**	(7)
		1,236	719
Profit before taxation		**5,855**	4,848
Taxation on ordinary activities	6	**(1,333)**	(1,455)
Profit for the year		**4,522**	3,393
Attributable to:			
Owners of the parent		**4,290**	3,115
Non-controlling interests		**232**	278
		4,522	3,393
Earnings per share			
Basic	7	**230.9p**	167.1p
Diluted	7	**230.3p**	166.6p

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	2015 £m	2014 £m
Profit for the year (page 125)		**4,522**	3,393
Other comprehensive income			
Items that may be reclassified subsequently to profit or loss:		**(849)**	(327)
Differences on exchange			
- subsidiaries		**(1,006)**	(539)
- associates		**336**	113
Cash flow hedges			
- net fair value (losses)/gains		**(99)**	57
- reclassified and reported in profit for the year		**15**	(67)
- reclassified and reported in net assets		**(45)**	8
Available-for-sale investments			
- net fair value gains		**15**	15
- reclassified and reported in profit for the year		**(10)**	—
Net investment hedges			
- net fair value (losses)/gains		**(118)**	2
- differences on exchange on borrowings		**42**	60
Tax on items that may be reclassified	6(f)	**21**	24
Items that will not be reclassified subsequently to profit or loss:		**263**	(458)
Retirement benefit schemes			
- net actuarial gains/(losses) in respect of subsidiaries	12	**283**	(428)
- surplus recognition and minimum funding obligations in respect of subsidiaries	12	**—**	7
- actuarial gains/(losses) in respect of associates net of tax	5	**3**	(124)
Tax on items that will not be reclassified	6(f)	**(23)**	87
Total other comprehensive income for the year, net of tax		**(586)**	(785)
Total comprehensive income for the year, net of tax		**3,936**	2,608
Attributable to:			
Owners of the parent		**3,757**	2,349
Non-controlling interests		**179**	259
		3,936	2,608

The accompanying notes are an integral part of the Group financial statements.

Group Statement of Changes in Equity
At 31 December

	Notes	Share capital	Share premium, capital redemption and merger reserves	Other reserves	Retained earnings	Total attributable to owners of parent	Non-controlling interests	Total equity
		Attributable to owners of the parent						
		£m	£m	£m	£m	£m	£m	£m
Balance at 1 January 2015		**507**	**3,923**	**(498)**	**1,578**	**5,510**	**304**	**5,814**
Total comprehensive income for the year (page 126)		**—**	**—**	**(796)**	**4,553**	**3,757**	**179**	**3,936**
Profit for the year		**—**	**—**	**—**	**4,290**	**4,290**	**232**	**4,522**
Other comprehensive income for the year		**—**	**—**	**(796)**	**263**	**(533)**	**(53)**	**(586)**
Employee share options								
- value of employee services		**—**	**—**	**—**	**50**	**50**	**—**	**50**
- proceeds from shares issued		**—**	**4**	**—**	**—**	**4**	**—**	**4**
Dividends and other appropriations								
- ordinary shares		**—**	**—**	**—**	**(2,770)**	**(2,770)**	**—**	**(2,770)**
- to non-controlling interests		**—**	**—**	**—**	**—**	**—**	**(238)**	**(238)**
Purchase of own shares								
- held in employee share ownership trusts		**—**	**—**	**—**	**(46)**	**(46)**	**—**	**(46)**
Non-controlling interests — acquisitions	26(c)	**—**	**—**	**—**	**(1,642)**	**(1,642)**	**(107)**	**(1,749)**
Other movements		**—**	**—**	**—**	**31**	**31**	**—**	**31**
Balance at 31 December 2015		**507**	**3,927**	**(1,294)**	**1,754**	**4,894**	**138**	**5,032**

	Notes	Share capital	Share premium, capital redemption and merger reserves	Other reserves	Retained earnings	Total attributable to owners of parent	Non-controlling interests	Total equity
		Attributable to owners of the parent						
		£m	£m	£m	£m	£m	£m	£m
Balance at 1 January 2014		507	3,919	(190)	2,398	6,634	301	6,935
Total comprehensive income for the year (page 126)		—	—	(308)	2,657	2,349	259	2,608
Profit for the year		—	—	—	3,115	3,115	278	3,393
Other comprehensive income for the year		—	—	(308)	(458)	(766)	(19)	(785)
Employee share options								
- value of employee services		—	—	—	66	66	—	66
- proceeds from shares issued		—	4	—	1	5	—	5
Dividends and other appropriations								
- ordinary shares		—	—	—	(2,712)	(2,712)	—	(2,712)
- to non-controlling interests		—	—	—	—	—	(260)	(260)
Purchase of own shares								
- held in employee share ownership trusts		—	—	—	(49)	(49)	—	(49)
- share buy-back programme		—	—	—	(800)	(800)	—	(800)
Non-controlling interests — acquisitions	26(c)	—	—	—	(4)	(4)	—	(4)
Non-controlling interests — capital injection	26(c)	—	—	—	—	—	4	4
Other movements		—	—	—	21	21	—	21
Balance at 31 December 2014		507	3,923	(498)	1,578	5,510	304	5,814

The accompanying notes are an integral part of the Group financial statements.

Group Balance Sheet
At 31 December

	Notes	2015	2014
		£m	**£m**
Assets			
Non-current assets			
Intangible assets	9	**10,436**	10,804
Property, plant and equipment	10	**3,021**	3,004
Investments in associates and joint ventures	11	**6,938**	2,400
Retirement benefit assets	12	**408**	40
Deferred tax assets	13	**326**	311
Trade and other receivables	14	**248**	153
Available-for-sale investments	15	**37**	36
Derivative financial instruments	16	**287**	287
Total non-current assets		**21,701**	17,035
Current assets			
Inventories	17	**4,247**	4,133
Income tax receivable	18	**74**	57
Trade and other receivables	14	**3,266**	2,768
Available-for-sale investments	15	**35**	50
Derivative financial instruments	16	**209**	274
Cash and cash equivalents	19	**1,963**	1,818
		9,794	9,100
Assets classified as held-for-sale	26(e)	**20**	32
Total current assets		**9,814**	9,132
Total assets		**31,515**	26,167
Equity			
Capital and reserves			
Share capital		**507**	507
Share premium, capital redemption and merger reserves		**3,927**	3,923
Other reserves		**(1,294)**	(498)
Retained earnings		**1,754**	1,578
Owners of the parent		**4,894**	5,510
after deducting			
- cost of treasury shares		**(5,049)**	(5,073)
Non-controlling interests		**138**	304
Total equity	20	**5,032**	5,814
Liabilities			
Non-current liabilities			
Borrowings	21	**14,806**	9,779
Retirement benefit liabilities	12	**653**	781
Deferred tax liabilities	13	**563**	495
Other provisions for liabilities and charges	22	**296**	278
Trade and other payables	23	**1,029**	128
Derivative financial instruments	16	**130**	123
Total non-current liabilities		**17,477**	11,584
Current liabilities			
Borrowings	21	**2,195**	2,479
Income tax payable	18	**414**	430
Other provisions for liabilities and charges	22	**273**	210
Trade and other payables	23	**5,937**	5,524
Derivative financial instruments	16	**187**	126
Total current liabilities		**9,006**	8,769
Total equity and liabilities		**31,515**	26,167

The accompanying notes are an integral part of the Group financial statements.

On behalf of the Board

Richard Burrows
Chairman

24 February 2016

Group Cash Flow Statement
For the year ended 31 December

	Notes	2015 £m	2014 £m
Cash flows from operating activities			
Cash generated from operations	25	**5,400**	4,634
Dividends received from associates		**593**	515
Tax paid		**(1,273)**	(1,433)
Net cash generated from operating activities		**4,720**	3,716
Cash flows from investing activities			
Interest received		**64**	61
Dividends received from investments		**—**	2
Purchases of property, plant and equipment		**(483)**	(529)
Proceeds on disposal of property, plant and equipment	25	**108**	62
Purchases of intangibles		**(118)**	(163)
Purchases of investments	25	**(99)**	(31)
Proceeds on disposals of investments	25	**45**	34
Proceeds from associates' share buy-backs	25	**—**	94
Investment in associates	25	**(3,015)**	—
Acquisition of subsidiaries	25	**(493)**	—
Net cash used in investing activities		**(3,991)**	(470)
Cash flows from financing activities			
Interest paid		**(596)**	(571)
Interest element of finance lease rental payments		**(1)**	—
Capital element of finance lease rental payments		**(2)**	(2)
Proceeds from issue of shares to owners of the parent		**4**	4
Proceeds from the exercise of options over own shares held in employee share ownership trusts		**—**	1
Proceeds from increases in and new borrowings	25	**6,931**	1,967
Proceeds relating to derivative financial instruments	25	**201**	244
Purchases of own shares		**—**	(800)
Purchases of own shares held in employee share ownership trusts		**(46)**	(49)
Reductions in and repayments of borrowings	25	**(2,028)**	(1,300)
Dividends paid to owners of the parent	8	**(2,770)**	(2,712)
Purchases of non-controlling interests	25	**(1,677)**	(4)
Non-controlling interests — capital injection	25	**—**	4
Dividends paid to non-controlling interests		**(235)**	(249)
Net cash used in financing activities		**(219)**	(3,467)
Net cash flows generated from/(used in) operating, investing and financing activities		**510**	(221)
Differences on exchange		**(272)**	(63)
Increase/(decrease) in net cash and cash equivalents in the year		**238**	(284)
Net cash and cash equivalents at 1 January		**1,492**	1,776
Net cash and cash equivalents at 31 December	19	**1,730**	1,492

The accompanying notes are an integral part of the Group financial statements.

The net cash outflows relating to adjusting items, including £97 million of interest, are £577 million (2014: £750 million). The FII GLO receipt in 2015 from HMRC was £963 million (see note 6(b)) and has been included in 'Cash generated from operations' above (see note 25).

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 Group financial statements are prepared on a going concern basis, as set out in the Financial Review on page 35.

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

The preparation of the Group 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 budgeted cash flows of these 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 judgements made in conjunction with independent actuaries. These involve estimates about uncertain future events based on the environment in different countries, including life expectancy of scheme members, salary and pension increases, inflation, 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. The recognised deferred tax assets and liabilities, together with a note of unrecognised amounts, are shown in note 13, and a contingent tax asset is explained in note 6(b). 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 application of these accounting policies to the payments made and credits recognised under the Master Settlement Agreement by Reynolds American Inc. is described in note 5;
- the definition of adjusting items, which are separately disclosed as memorandum information, is explained below and the impact of these on the calculation of adjusted earnings is described in note 7;
- the estimation of the fair values of acquired net assets arising in a business combination and the allocation of the purchase consideration between the underlying net assets acquired, including intangible assets other than goodwill, on the basis of their fair values. These estimates are prepared in conjunction with the advice of independent valuation experts where appropriate. The relevant transactions for 2015 are described in note 26 and in note 11;
- the determination as to whether control (subsidiaries), joint control (joint arrangements), or significant influence (associates) exists in relation to the investments held by the Group. This is assessed after taking into account the Group's ability to appoint directors to the entity's board, its relative shareholding compared with other shareholders, any significant contracts or arrangements with the entity or its other shareholders and other relevant facts and circumstances. The application of this judgement in respect of the Group's investment in Reynolds American Inc. is explained in note 11;
- the review of applicable exchange rates for transactions with and translation of entities in territories where there are restrictions on the free access to foreign currency, or multiple exchange rates; and
- the exemptions taken under IFRS 1 on the first time adoption of IFRS at 1 January 2004 and, in particular, those relating to goodwill on business combinations which are explained in the accounting policies below.

Such estimates and assumptions are based on historical experience and various other factors that are believed to be reasonable in the circumstances and constitute management's best judgement at the date of the financial statements. In the future, actual experience may deviate from these estimates and assumptions, which could affect the financial statements as the original estimates and assumptions are modified, as appropriate, in the year in which the circumstances change.

Basis of consolidation

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

A subsidiary is an entity controlled by the Group. The Group controls an entity when the Group is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity.

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

Joint arrangements comprise contractual arrangements where two or more parties have joint control and where decisions regarding the relevant activities of the entity require unanimous consent. Joint operations are jointly-controlled arrangements where the parties to the arrangement have rights to the underlying assets and obligations for the underlying liabilities relating to the arrangement. The Group accounts for its share of the assets, liabilities, income and expenses of any such arrangement. Joint ventures comprise arrangements where the parties to the arrangement have rights to the net assets of the arrangement. They are accounted for using the equity method.

The results of subsidiary undertakings acquired during the period are included from the date of acquisition of a controlling interest at which date, for the purposes of consolidation, the purchase consideration is allocated between the underlying net assets acquired, including intangible assets other than goodwill, on the basis of their fair value. Acquisition-related costs are expensed as incurred. Similarly, the results of associates and joint arrangements are included from the date of acquiring significant influence or joint control respectively.

The results of subsidiary undertakings, associates and joint arrangements which have been sold during the year are included up to the date of disposal. The profit or loss on sale is calculated by reference to the net asset value at the date of disposal, adjusted for purchased goodwill previously consolidated in the balance sheet.

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

Foreign currencies

The functional currency of the parent company is sterling and this is also the presentation currency of the Group. The income and cash flow statements of Group undertakings expressed in currencies other than sterling are translated to sterling using exchange rates applicable to the dates of the underlying transactions. Average rates of exchange in each year are used where the average rate approximates the relevant exchange rate at the date of the underlying transactions. Assets and liabilities of Group undertakings are translated at the applicable rates of exchange at the end of each year. In territories where there are restrictions on the free access to foreign currency or multiple exchange rates, the applicable rates of exchange are regularly reviewed.

For hyperinflationary countries, the financial statements in local currency are adjusted to reflect the impact of local inflation prior to translation into sterling.

The differences between retained profits of overseas subsidiary undertakings, associates and joint arrangements translated at average and closing rates of exchange are taken to reserves, as are differences arising on the retranslation to sterling (using closing rates of exchange) of overseas net assets at the beginning of the year. Any differences that have arisen since 1 January 2004 are presented as a separate component of equity. As permitted under IFRS 1, any differences prior to that date are not included in this separate component of equity.

Where a disposal of an investment in a Group undertaking results in a loss of control of a subsidiary undertaking, the loss of significant influence over an associated company or the loss of joint control over a joint arrangement, the cumulative amount of the related foreign exchange differences deferred in the separate component of equity are recognised in the income statement when the gain or loss on disposal is recognised. These related exchange differences comprise the exchange differences on all amounts deemed to be part of the

net investment in the undertaking, which are recycled to the income statement when a disposal occurs. For partial disposals of subsidiary undertakings the related exchange differences are reclassified within equity. For all other partial disposals the proportional share of the related exchange differences is recycled to the income statement. Foreign currency transactions are initially recognised in the functional currency of each entity in the Group using the exchange rate ruling at the date of the transaction. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation of foreign currency assets and liabilities at year end rates of exchange are recognised in the income statement, except when deferred in equity as qualifying cash flow hedges, on inter-company net investment loans and qualifying net investment hedges. Foreign exchange gains or losses recognised in the income statement are included in profit from operations or net finance costs depending on the underlying transactions that gave rise to these exchange differences.

Revenue

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

Retirement benefit costs

The Group operates both defined benefit and defined contribution schemes. The net deficit or surplus for each defined benefit pension scheme is calculated in accordance with IAS 19 Employee Benefits, based on the present value of the defined benefit obligation at the balance sheet date less the fair value of the scheme assets adjusted, where appropriate, for any surplus restrictions or the effect of minimum funding requirements.

Actuarial gains and losses, changes in unrecognised scheme surpluses and minimum funding requirements are recognised in full through other comprehensive income. Past service costs or credits resulting from amendments to benefits are recognised immediately.

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

For defined benefit schemes, the actuarial cost charged to profit from operations consists of current service cost, net interest on the net defined benefit liability or asset, past service cost and the impact of any settlements.

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 substantively enacted at the balance sheet date in the countries where the Group's subsidiaries, associates and joint arrangements operate and generate taxable income.

Deferred taxation is provided in full using the liability method for temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and the amount used for taxation purposes. Deferred tax is provided on temporary differences arising on investments in Group undertakings, except where the timing of the reversal of the temporary difference is controlled by the Group and it is probable that it will not reverse in the foreseeable future. A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. As required under IAS 12 *Income Taxes*, deferred tax assets and liabilities are not discounted.

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

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

The Group has exposures in respect of the payment or recovery of a number of taxes. Liabilities or assets for these payments or recoveries are recognised at such time as an outcome becomes probable and when the amount can reasonably be estimated.

Goodwill

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

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

The Group's policy up to and including 1997 was to eliminate goodwill against reserves. Goodwill acquired from 1998 to 31 December 2003 was capitalised and amortised over its useful economic life.

As permitted under IFRS 1, in respect of acquisitions prior to 1 January 2004, the classification and accounting treatment of business combinations was not amended on transition to IFRS. Goodwill previously written off direct to reserves is not recycled to the income statement on the disposal of the subsidiary, associate or joint venture to which it relates.

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

Intangible assets other than goodwill

The intangible assets shown on the Group balance sheet consist mainly of trademarks and similar intangibles, including certain intellectual property, acquired by the Group's subsidiary undertakings and computer software.

Acquired trademarks and similar assets are carried at cost less accumulated amortisation and impairment. Trademarks with indefinite lives are not amortised but are reviewed annually for impairment. Intangible assets other than goodwill classified as held-for-sale are not amortised. Other trademarks and similar assets are amortised on a straight-line basis over their remaining useful lives, consistent with the pattern of economic benefits expected to be received, which do not exceed 20 years. Any impairments of trademarks are recognised in the income statement but increases in trademark values are not recognised.

Computer software is carried at cost less accumulated amortisation and impairment, and, with the exception of global software solutions, is amortised on a straight-line basis over periods ranging from three years to five years. Global software solutions are software assets designed to be implemented on a global basis and used as a standard solution by all of the operating companies in the Group. These assets are amortised on a straight-line basis over periods not exceeding 10 years.

The investments in associates and joint ventures shown in the Group balance sheet include trademarks arising from the combination of Brown & Williamson (B&W) and R.J. Reynolds (RJR) in 2004 to form

Reynolds American Inc. (RAI), as well as those arising on the acquisition by RAI of Conwood in 2006 and Lorillard in 2015. Most of the carrying value of these assets relates to intangibles which are deemed to have indefinite lives and each trademark is subject to an annual impairment test. Certain minor trademarks are being amortised over their remaining lives.

Property, plant and equipment

Property, plant and equipment are stated at cost less accumulated depreciation and impairment. Depreciation is calculated on a straight-line basis to write off the assets over their useful economic life. No depreciation is provided on freehold land or assets classified as held-for-sale. Freehold and leasehold property are depreciated at rates between 2.5% and 4% per annum, and plant and equipment at rates between 7% and 25% per annum.

Capitalised interest

Borrowing costs which are directly attributable to the acquisition, construction or production of intangible assets or plant, property and equipment that takes a substantial period of time to get ready for its intended use or sale, and for which the commencement date for capitalisation was on or after 1 January 2009, are capitalised as part of the cost of the asset, in accordance with IAS 23 *Borrowing Costs*. The Group's previous policy was to expense such borrowing costs as they were incurred.

Leased assets

Assets where the Group has substantially all the risks and rewards of ownership of the leased asset are classified as finance leases and are included as part of property, plant and equipment. Finance lease assets are initially recognised at an amount equal to the lower of their fair value and the present value of the minimum lease payments at inception of the lease, then depreciated over the shorter of the lease term and their estimated useful lives. Leasing payments consist of capital and finance charge elements and the finance element is charged to the income statement.

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

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

Impairment of non-financial assets

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

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

Impairment of financial assets

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

Inventories

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

Financial instruments

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

Financial assets and financial liabilities are initially recognised at fair value, plus directly attributable transaction costs where applicable, with subsequent measurement as set out below.

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

Available-for-sale investments

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

Loans and receivables

These are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market.

Cash and cash equivalents

Cash and cash equivalents include cash in hand and deposits held on call, together with other short-term highly liquid investments including investments in certain money market funds. Cash equivalents normally comprise instruments with maturities of three months or less at date of acquisition. In the cash flow statement, cash and cash equivalents are shown net of bank overdrafts, which are included as current borrowings in the liabilities section on the balance sheet.

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 primarily a single product business providing cigarettes and other tobacco products. While the Group has clearly differentiated brands, global segmentation between a wide portfolio of brands is not part of the regular internally reported financial information. The results of Next Generation Products are not currently material to the Group.

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

Adjusting items

Adjusting items are significant items in the profit from operations, net finance costs, taxation and the Group's share of the post-tax results of associates and joint ventures which individually or, if of a similar type, in aggregate, are relevant to an understanding of the Group's underlying financial performance. While the disclosure of adjusting items is not required by IFRS, these items are separately disclosed either as memorandum information on the face of the income statement and in the segmental analyses, or in the notes to the accounts as appropriate.

The Group believes that these items are useful to users of the Group financial statements in helping them to understand the underlying business performance and are used to derive the Group's principal non-GAAP measures of adjusted profit from operations and adjusted diluted earnings per share.

Provisions

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

Contingent liabilities and contingent assets

Subsidiaries and associates companies are defendants in tobacco-related and other litigation. Provision for this litigation (including legal costs) 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.

Where a provision has not been recognised, the Group records its external legal fees and other external defence costs for tobacco-related and other litigation as these costs are incurred.

Repurchase of share capital

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

Future changes to accounting policies

Certain changes to IFRS will be applicable to the Group financial statements in future years. Set out below are those which are considered to be most relevant to the Group.

IFRS 9 *Financial Instruments*. This standard was finalised and published in July 2014 as the replacement for IAS 39 *Financial Instruments*: *Recognition and Measurement*. Further due diligence will be carried out before implementation, but the anticipated impact from restatement on the Group's reported profit and equity for 2015 and 2014 is not expected to be material. The Standard is largely retrospective in application. Subject to EU endorsement, the expected mandatory effective date of implementation is 1 January 2018.

IFRS 15 *Revenue from Contracts with Customers*. This standard was finalised and published in May 2014 with the intention to harmonise IFRS and US GAAP through a single revenue recognition standard. Further due diligence will be carried out before implementation, but the anticipated impact from restatement on the Group's operating profit for 2015 and 2014 is not expected to be material. However, this standard may require changes to the allocation of costs between operating expenses and deductions from revenue, for example, payments to customers currently classed as expenses. The Standard is retrospective in application. Subject to EU endorsement, the expected mandatory effective date of implementation is 1 January 2018.

IFRS 16 *Leases*. This standard was finalised and published in January 2016 and is a major revision to the way that entities will account for leases. The distinction between operating leases and finance leases enshrined in current accounting requirements (IAS 17) is removed with the effect that virtually all leasing arrangements will be brought on to the balance sheet as financial obligations and 'right-to-use' assets. Further due diligence will be carried out before implementation, but the anticipated impact from restatement on the Group's operating profit and net assets for 2015 and 2014 is not expected to be material, although assets and liabilities would have been grossed up by approximately £220 million in both years based on current leasing commitments as disclosed in note 30. The Standard is retrospective in application, but allows for implementation either as a single cumulative amount at the date of initial application or as an adjustment to each prior reporting period. Subject to EU endorsement, the expected mandatory effective date of implementation is 1 January 2019.

In addition, a number of other interpretations and revisions to existing standards have been issued which will be applicable to the Group's financial statements in future years, but will not have a 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 to the overall business. The results of Next Generation Products as a separate segment are currently not material to the Group and therefore it is not considered a reportable segment that requires separate disclosure under the requirements of IFRS 8 Operating Segments. Interest income, interest expense and taxation are centrally managed and accordingly such items are not presented by segment as they are excluded from the measure of segment profitability.

The four geographic regions are the reportable segments for the Group as they form the focus of the Group's internal reporting systems and are the basis used by the Management Board for assessing performance and allocating resources.

The Management Board reviews current and prior year segmental revenue, adjusted profit from operations of subsidiaries and joint operations, and adjusted post-tax results of associates and joint ventures at constant rates of exchange. The constant rate comparison provided for reporting segment information is based on a retranslation, at prior year exchange rates, of the current year results of the Group, including inter-company royalties payable in foreign currency to UK entities. However, the Group does not adjust for the normal transactional gains and losses in operations which are generated by movements in exchange rates. As a result, the 2015 segmental results were translated using the 2014 rates of exchange. The 2014 figures are stated at the 2014 rates of exchange and are, therefore, unadjusted from those published for 2014.

The analyses of revenue for the 12 months to 31 December 2015 and 31 December 2014, based on location of sales, are as follows:

	2015			2014
	Revenue Constant rates	Translation exchange	Revenue Current rates	Revenue
	£m	£m	£m	£m
Asia-Pacific	**3,874**	**(101)**	**3,773**	3,873
Americas	**3,340**	**(620)**	**2,720**	2,990
Western Europe	**3,476**	**(273)**	**3,203**	3,359
EEMEA	**4,030**	**(622)**	**3,408**	3,749
Revenue	**14,720**	**(1,616)**	**13,104**	13,971

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:

	2015					2014		
	Adjusted* segment result Constant rates	Translation exchange	Adjusted* segment result Current rates	Adjusting items	Segment result Current rates	Adjusted* segment result	Adjusting items	Segment result
	£m	£m	£m	£m	£m	£m	£m	£m
Asia-Pacific	**1,546**	**(77)**	**1,469**	**(108)**	**1,361**	1,548	(188)	1,360
Americas	**1,426**	**(257)**	**1,169**	**(87)**	**1,082**	1,286	(89)	1,197
Western Europe	**1,249**	**(103)**	**1,146**	**(156)**	**990**	1,189	(171)	1,018
EEMEA	**1,399**	**(191)**	**1,208**	**(81)**	**1,127**	1,380	(62)	1,318
	5,620	**(628)**	**4,992**	**(432)**	**4,560**	5,403	(510)	4,893
Fox River**				**—**	**—**		27	27
Flintkote**				**(3)**	**(3)**		(374)	(374)
Profit from operations	**5,620**	**(628)**	**4,992**	**(435)**	**4,557**	5,403	(857)	4,546
Net finance income/(costs)	**(464)**	**37**	**(427)**	**489**	**62**	(417)	—	(417)
Asia-Pacific	**278**	**8**	**286**	**16**	**302**	277	14	291
Americas	**610**	**46**	**656**	**277**	**933**	431	(7)	424
EEMEA	**1**	**—**	**1**	**—**	**1**	4	—	4
Share of post-tax results of associates and joint ventures	**889**	**54**	**943**	**293**	**1,236**	712	7	719
Profit before taxation	**6,045**	**(537)**	**5,508**	**347**	**5,855**	5,698	(850)	4,848

* The adjustments to profit from operations, net finance income/(costs) and the Group's share of the post-tax results of associates and joint ventures are explained in notes 3(e) to 3(h), note 4(b) and note 5, respectively.

** The Fox River credit in 2014 (see note 3(g) and note 30) and the Flintkote charge in 2014 and 2015 (see note 3(h) and note 30) have not been allocated to any segment as they neither relate to current operations nor the tobacco business. They are presented separately from the segmental reporting which is used to evaluate segment performance and to allocate resources, and is reported to the chief operating decision maker on this basis.

Notes on the Accounts (Continued)

Adjusted profit from operations at constant rates of £5,620 million (2014: £5,403 million) excludes certain depreciation, amortisation and impairment charges as explained in notes 3(b), 3(e) and 3(f). These are excluded from segmental profit from operations at constant rates as follows:

	2015					2014		
	Adjusted depreciation, amortisation and impairment Constant rates	Translation exchange	Adjusted depreciation, amortisation and impairment Current rates	Adjusting items	Depreciation, amortisation and impairment Current rates	Adjusted depreciation, amortisation and impairment	Adjusting items	Depreciation, amortisation and impairment
	£m	£m	£m	£m	£m	£m	£m	£m
Asia-Pacific	**95**	**—**	**95**	**33**	**128**	96	52	148
Americas	**96**	**(12)**	**84**	**9**	**93**	106	17	123
Western Europe	**81**	**(6)**	**75**	**39**	**114**	96	50	146
EEMEA	**97**	**(14)**	**83**	**10**	**93**	98	8	106
	369	**(32)**	**337**	**91**	**428**	396	127	523

External revenue and non-current assets other than financial instruments, deferred tax assets and retirement benefit assets are analysed between the UK and all foreign countries at current rates of exchange as follows:

	United Kingdom		All foreign countries		Group	
	2015	2014	2015	2014	2015	2014
	£m	£m	£m	£m	£m	£m
Revenue is based on location of sale						
External revenue	**190**	143	**12,914**	13,828	**13,104**	13,971

	United Kingdom		All foreign countries		Group	
	2015	2014	2015	2014	2015	2014
	£m	£m	£m	£m	£m	£m
Intangible assets	**580**	499	**9,856**	10,305	**10,436**	10,804
Property, plant and equipment	**378**	343	**2,643**	2,661	**3,021**	3,004
Investments in associates and joint ventures	**—**	—	**6,938**	2,400	**6,938**	2,400

In 2014, Souza Cruz S.A. operating in Brazil met the criteria for separate disclosure under the requirements of IFRS 8 Operating Segments. Revenue and non-current assets for Souza Cruz operations in 2014 amounted to £1,602 million and £399 million, respectively. In 2015, there is no foreign operation that requires separate disclosure under the requirements of IFRS 8 Operating Segments.

The main acquisitions comprising the goodwill balance of £9,324 million (2014: £9,842 million), included in intangible assets, are provided in note 9. Included in investments in associates and joint ventures are amounts of £5,749 million (2014: £1,361 million) attributable to the investment in Reynolds American Inc. and £1,136 million (2014: £991 million) attributable to the investment in ITC Ltd. Further information is provided in note 11.

3 Profit from operations

(a) Employee benefit costs

	2015	2014
	£m	£m
Wages and salaries	**1,667**	1,776
Social security costs	**174**	212
Other pension and retirement benefit costs (note 12)	**138**	132
Share-based payments — equity-settled (note 27)	**50**	66
Share-based payments — cash-settled (note 27)	**10**	8
	2,039	2,194

(b) Depreciation, amortisation and impairment costs

		2015 £m	2014 £m
Intangibles	- amortisation of trademarks and similar intangibles (note 3(f))	**65**	58
	- amortisation of other intangibles	**74**	58
	- impairment	**15**	11
Property, plant and equipment	- depreciation	**265**	307
	- impairment	**9**	89
		428	523

Impairment in respect of certain intangibles, and property, plant and equipment is included in restructuring costs (see note 3(e)).

(c) Other operating income

This represents operating income arising from the Group's activities which falls outside the definition of revenue and includes gains as a result of property disposals, service fees and other shared costs charged to third parties, manufacturing fees and trademark income.

(d) Other operating expenses include:

	2015 £m	2014 £m
Research and development expenses (excluding employee benefit costs and depreciation)	**60**	74
Exchange differences	**10**	7
Rent of plant and equipment (operating leases)		
- minimum lease payments	**20**	28
Rent of property (operating leases)		
- minimum lease payments	**52**	69
Fees payable for audit services pursuant to legislation:		
- fees payable to KPMG LLP for parent company and Group audit	**2.0**	0.3
- fees payable to PricewaterhouseCoopers LLP for parent company and Group audit	**—**	2.0
- fees payable to other KPMG LLP firms and associates for local statutory and Group reporting audits	**6.7**	—
- fees payable to other PricewaterhouseCoopers LLP firms and associates for local statutory and Group reporting audits	**0.6**	7.3
Audit fees payable to KPMG LLP firms and associates	**8.7**	0.3
Audit fees payable to PricewaterhouseCoopers LLP firms and associates	**0.6**	9.3
Audit fees payable to other firms	**—**	0.1
Total audit fees payable	**9.3**	9.7
Fees payable to KPMG LLP (2015)/PricewaterhouseCoopers LLP (2014) firms and associates for other services:		
- audit-related assurance services	**0.2**	0.3
- other assurance services	**0.1**	0.1
- tax advisory services	**0.6**	3.8
- tax compliance	**0.4**	0.8
- other non-audit services	**2.0**	0.2
	3.3	5.2

The total fees payable to PricewaterhouseCoopers firms and associates included above are £0.6 million (2014: £14.5 million). The total fees payable to KPMG firms and associates included above are £12.0 million (2014: £0.3 million).

Total research and development costs including employee benefit costs and depreciation are £148 million (2014: £154 million).

(e) Restructuring and integration costs

Restructuring costs reflect the costs incurred as a result of initiatives to improve the effectiveness and the efficiency of the Group as a globally integrated enterprise, including the relevant operating costs of implementing the new operating model. These costs represent additional expenses incurred, which are not related to the normal business and day-to-day activities. The new operating model includes revised organisation structures, standardised processes and shared back office services underpinned by a global single instance of SAP. The new organisation structures and processes are currently being implemented and the deployment of the new SAP system started in the third quarter of 2012 and will take at least four years to fully roll-out. These initiatives also include a review of the Group's manufacturing operations, supply chain, overheads and indirect costs, organisational structure and systems and software used. The costs of these initiatives together with the costs of integrating acquired businesses into existing operations, including acquisition costs, are included in profit from operations under the following headings:

	2015	2014
	£m	£m
Employee benefit costs	**159**	223
Depreciation, amortisation and impairment costs	**26**	69
Other operating expenses	**228**	180
Other operating income	**(46)**	(20)
	367	452

Restructuring and integration costs in 2015 principally relate to the restructuring initiatives directly related to implementation of a new operating model and the cost of initiatives in respect of permanent headcount reductions and permanent employee benefit reductions in the Group. The costs also cover factory closure and downsizing activities in Australia, certain costs related to the acquisitions undertaken (including TDR in Croatia) and restructurings in Indonesia, Canada, Switzerland and Germany.

Restructuring and integration costs in 2014 principally related to the restructuring initiatives directly related to implementation of a new operating model and the cost of packages in respect of permanent headcount reductions and permanent employee benefit reductions in the Group. The costs also covered factory closure and downsizing activities in Australia, Colombia and the Democratic Republic of Congo, and restructurings in Argentina, Indonesia, Canada, Switzerland and Germany.

Other operating income in 2015 includes gains from the sale of land and buildings in Australia. In 2014, other operating income included gains from the sale of land and buildings in Turkey, Uganda and the Democratic Republic of Congo.

(f) Amortisation of trademarks and similar intangibles

The acquisitions of TDR (see note 26), Protabaco, Bentoel, Tekel, ST, CN Creative and the creation of CTBAT International Limited resulted in the capitalisation of trademarks and similar intangibles which are amortised over their expected useful lives, which do not exceed 20 years. The amortisation charge of £65 million (2014: £58 million) is included in depreciation, amortisation and impairment costs in profit from operations.

(g) Fox River

As explained in note 30, a Group subsidiary has certain liabilities in respect of indemnities given on the purchase and disposal of former businesses in the US and in 2011, the subsidiary provided £274 million in respect of claims in relation to environmental clean-up costs of the Fox River.

On 30 September 2014, a Group subsidiary, NCR, Appvion and Windward Prospects entered into a Funding Agreement with regard to the costs for the clean-up of Fox River. Based on this Funding Agreement, £17 million has been paid in 2015, which includes legal costs of £8 million (2014: £56 million, including legal costs of £7 million). The Fox River provision has been reviewed with no further change required in 2015, following a release in 2014 of £27 million. The remaining provision is £160 million (2014: £177 million).

(h) Flintkote

As explained in note 30, in December 2014, a Group subsidiary entered into a settlement agreement in connection with various legal cases related to a former non-tobacco business in Canada. Under the terms of the settlement, the subsidiary will obtain protection from current and potential future Flintkote-related asbestos liability claims in the US. The settlement was finalised in 2015 when approvals of certain courts in the US were obtained. This agreement has led to a charge of £3 million in 2015 (2014: £374 million).

4 Net finance (income)/costs

(a) Net finance (income)/costs

	2015 £m	2014 £m
Finance costs		
- interest payable		
- bonds and notes	**484**	501
- other loans and commercial paper	**36**	22
- bank loans and overdrafts	**53**	56
- facility fees	**9**	9
- interest and fees related to the funding of the acquisition of non-controlling interests in Souza Cruz and the investment in RAI (see note 4(b)(i))	**16**	—
- interest related to Franked Investment Income Global Litigation Order (see note 4(b)(iii))	**8**	—
	606	588
- fair value changes on derivative financial instruments and hedged items	**(245)**	(154)
- derivatives costs related to the funding of the acquisition of non-controlling interests in Souza Cruz (see note 4(b)(i))	**88**	—
- exchange differences on financial liabilities	**135**	50
	584	484
Finance income		
- interest and dividend income		
- gains in respect of available-for-sale investments	**(10)**	—
- dividend income in respect of available-for-sale investments	**—**	(2)
- other interest income	**(69)**	(65)
	(79)	(67)
- deemed gain related to the investment in RAI (see note 4(b)(ii))	**(601)**	—
- exchange differences on financial assets	**34**	—
	(646)	(67)
Net finance (income)/costs	**(62)**	417

The Group manages foreign exchange gains and losses and fair value changes on a net basis excluding adjusting items, as shown below. Adjusting items are explained separately in note 4(b). The derivatives that generate the fair value changes are detailed in note 16.

	2015 £m	2014 £m
Fair value changes		
- cash flow hedges transferred from equity	**(18)**	(31)
- fair value hedging instruments — exchange-related movements	**(27)**	12
- fair value hedging instruments — net interest income	**(75)**	(83)
- fair value hedging instruments — interest-related movements *(note (i))*	**(27)**	(174)
- fair value changes on hedged items — interest-related movements *(note (i))*	**22**	158
- instruments held-for-trading *(note (ii))*	**(120)**	(36)
	(245)	(154)
Finance costs — exchange differences on financial liabilities	**135**	50
Finance income — exchange differences on financial assets	**34**	—
	(76)	(104)

Notes:

(i) Hedge ineffectiveness in respect of fair value hedges is a £5 million gain (2014: £16 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 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.

Facility fees principally relate to the Group's central undrawn banking facilities of £3 billion and US$150 million (2014: £3 billion and US$150 million).

Exchange differences in respect of hedged items subject to fair value hedges and cash flow hedges were a loss of £27 million (2014: £12 million gain) and a loss of £18 million (2014: £36 million loss) respectively and are included in 'Finance costs — exchange differences' in the table above.

(b) Adjusting items included in net finance (income)/costs

Adjusting items are significant items in net finance costs which individually or, if of a similar type, in aggregate, are relevant to an understanding of the Group's underlying financial performance. Refer to note 1 for details on the Group adjusting items policy.

In 2015, the following adjusting items have been recognised:

(i) costs of £104 million in relation to financing activities, which includes costs on the acquisition of the non-controlling interests in the Group's Brazilian subsidiary, Souza Cruz S.A. and the Group's activities to maintain the current ownership in RAI following its acquisition of Lorillard, Inc.;

(ii) the Group's investment of US$4.7 billion in cash in RAI has realised a deemed gain of US$931 million (£601 million). This has arisen as the contract to acquire shares is deemed to be a financial instrument and has been fair valued through profit and loss, in compliance with IAS 39 Financial Instruments: Recognition and Measurement. The deemed gain reflects the difference between the fixed price paid by the Group to RAI and the market value of RAI shares on the day of the transaction (see note 11); and

(iii) as described in note 6, the Group received £963 million from HM Revenue & Customs in relation to the Franked Investment Income Group Litigation Order (FII GLO). The payment was received subject to an ongoing appeals process and was made with no admission of liability. This amount is included in deferred income (see note 23). Any future repayment by the Group is subject to interest and, as any recognition of income will be deemed to be adjusting (due to size), interest of £8 million has been accrued and treated as an adjusting item.

5 Associates and joint ventures

	2015		2014	
	Total	**Group's share**	**Total**	**Group's share**
	£m	**£m**	**£m**	**£m**
Revenue	**11,186**	**4,215**	9,201	3,402
Profit from operations	**6,117**	**2,391**	3,166	1,163
Net finance costs	**(335)**	**(139)**	(169)	(70)
Profit on ordinary activities before taxation	**5,782**	**2,252**	2,997	1,093
Taxation on ordinary activities	**(2,545)**	**(1,013)**	(1,006)	(370)
Profit on ordinary activities after taxation	**3,237**	**1,239**	1,991	723
Non-controlling interests	**(12)**	**(3)**	(11)	(4)
Post-tax results of associates and joint ventures	**3,225**	**1,236**	1,980	719
Analysed as:				
- adjusted share of post-tax results of associates and joint ventures	**2,501**	**943**	1,951	712
- issue of shares and change in shareholding	**74**	**22**	46	14
- gain on disposal of assets	**879**	**371**	—	—
- other	**(229)**	**(100)**	(17)	(7)
	3,225	**1,236**	1,980	719

(a) Adjusting items

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:

2015

In 2015, the Group's interest in ITC Ltd. (ITC) decreased from 30.26% to 30.06% as a result of ITC issuing ordinary shares under the company's Employee Share Option Scheme. The issue of these shares and change in

the Group's share of ITC resulted in a gain of £22 million, which is treated as a deemed partial disposal and included in the Group Income Statement.

Reynolds American Inc. (RAI) recognised a gain on the related divestiture of assets, following the Lorillard, Inc. (Lorillard) acquisition, of US$3,288 million. The Group's share of this net gain amounted to £371 million (net of tax).

RAI has also recognised amounts that have been combined in the table of adjusting items in the Group Income Statement and are included within "other". This includes restructuring charges of US$223 million, the Group's share of which is £39 million (net of tax) and costs in respect of a number of Engle progeny lawsuits and other tobacco litigation charges that amounted to US$152 million, the Group's share of which is £26 million (net of tax). Also included are transaction costs of US$54 million and financing costs of US$60 million connected with the acquisition of Lorillard, the Group's share of which is £12 million (net of tax) and £10 million (net of tax), respectively. Additionally, there is income of US$108 million related to the Non-Participating Manufacturer (NPM) Adjustment claims of the states no longer challenging the findings of non-diligence entered against them by an Arbitration Panel, the Group's share of which is £18 million (net of tax). The remaining costs of US$99 million are primarily in respect of asset impairment and exit charges, the Group's share of which is £25 million (net of tax).

2014

In 2014, the Group's interest in ITC decreased from 30.47% to 30.26% as a result of ITC issuing ordinary shares under the company's Employee Share Option Scheme. This resulted in a gain of £14 million, which was treated as a deemed partial disposal and included in the Group Income Statement.

RAI also recognised amounts that have been combined in the table of adjusting items in the Group Income Statement and are shown as "other". These are costs in respect of a number of Engle progeny lawsuits and other tobacco litigation charges that amount to US$102 million, the Group's share of which is £16 million (net of tax). RAI recognised income of US$34 million related to the 2013 MSA liability as an adjusting item. The Group's share of this income amounted to £5 million (net of tax). RAI recognised a net gain from discontinued activities of US$25 million, reduced by restructuring activities of US$16 million, resulting in a net gain of US$9 million. The Group's share of this net gain amounted to £4 million (net of tax).

(b) Master Settlement Agreement

In 1998, the major US cigarette manufacturers (including R.J. Reynolds and Brown & Williamson) entered into the Master Settlement Agreement (MSA) with attorney generals representing most US states and territories. The MSA imposes a perpetual stream of future payment obligations on the major US cigarette manufacturers. The amounts of money that the participating manufacturers are required to annually contribute are based upon, among other things, the volume of cigarettes sold and market share (based on cigarette shipments in that year). Given these facts, the Group's accounting for the MSA payments is to accrue for them in the cost of products sold as the products are shipped and no provision is made in respect of potential payments relating to future years. The event which gives rise to the obligation is the actual sale of products shipped and the MSA payments are therefore recognised as part of the costs of those business operations.

During 2013, RAI, various other tobacco manufacturers, 19 states, the District of Columbia and Puerto Rico reached a final agreement related to RAI's 2003 MSA activities. Under this agreement RAI will receive credits, currently estimated to be more than US$1 billion, in respect of its NPM Adjustment claims related to the period from 2003 to 2012. These credits will be applied against the company's MSA payments over a period of five years from 2013, subject to, and dependent upon, meeting the various ongoing performance obligations.

During 2014, two additional states agreed to settle NPM disputes related to claims for the period 2003 to 2012. It is estimated that RAI will receive US$170 million in credits, which will be applied over a five-year period from 2014.

During 2015, another state agreed to settle NPM disputes related to claims for the period 2004 to 2014. It is estimated that RAI will receive US$285 million in credits, which will be applied over a four-year period from 2015.

Credits in respect of future years' payments and the NPM Adjustment claims would be accounted for in the applicable year and will not be treated as adjusting items. Only credits in respect of prior year payments are included as adjusting items.

(c) Other financial information

	2015 Group's share £m	2014 Group's share £m
Profit on ordinary activities after taxation		
- attributable to owners of the Parent	**1,236**	719
Other comprehensive income:		
Differences on exchange	**336**	113
Net fair value gains on available-for-sale investments	**1**	15
Actuarial gains/(losses) relating to pensions and other post-retirement benefits (note 20)	**3**	(124)
Total comprehensive income (note 11)	**1,576**	723

	2015 Group's share £m	2014 Group's share £m
Dividends received		
- listed investments	**635**	510
- unlisted investments	**5**	8
Total dividends received from associates	**640**	518

Summarised financial information of the Group's associates and joint ventures:

	2015				2014			
	RAI £m	ITC £m	Others £m	Total £m	RAI £m	ITC £m	Others £m	Total £m
Revenue	**6,986**	**3,839**	**361**	**11,186**	**5,132**	**3,777**	**292**	**9,201**
Profit on ordinary activities before taxation	**4,250**	**1,505**	**27**	**5,782**	1,551	1,389	57	2,997
Post-tax results of associates and joint ventures	**2,203**	**1,005**	**17**	**3,225**	1,000	938	42	1,980
Other comprehensive income	**684**	**43**	**(24)**	**703**	(166)	184	(29)	(11)
Total comprehensive income	**2,887**	**1,048**	**(7)**	**3,928**	834	1,122	13	1,969

6 Taxation on ordinary activities

(a) Summary of taxation on ordinary activities

	2015 £m	2014 £m
UK corporation tax	**5**	—
Overseas tax	**1,324**	1,450
Comprising:		
- current year tax expense	**1,317**	1,439
- adjustments in respect of prior periods	**7**	11
Total current tax	**1,329**	1,450
Deferred tax	**4**	5
Comprising:		
- deferred tax relating to origination and reversal of temporary differences	**(11)**	7
- deferred tax relating to changes in tax rates	**15**	(2)
	1,333	1,455

(b) Franked Investment Income Group Litigation Order

British American Tobacco is the principal test claimant in an action in the UK against HM Revenue and Customs (HMRC) in the Franked Investment Income Group Litigation Order (FII GLO). There are 25 corporate groups in the FII GLO. The case concerns the treatment for UK corporation 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, among other things, that the corporation tax provisions relating to dividend income from EU subsidiaries breached EU law. 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 creditable against advance corporation tax (ACT) liabilities with the consequence that ACT need not have been paid. Claims for the repayment of UK tax incurred where the dividends were from the EU were allowed back to 1973.

The case was heard by the Court of Appeal in October 2009 and the judgment handed down on 23 February 2010. The Court of Appeal determined that various questions, including which companies in the corporate tree can be included in a claim, should be referred back to the ECJ for further clarification. In addition, the Court determined that the claim should be restricted to six years and not cover claims dating back to 1973.

The issue of time limits was heard by the Supreme Court in February 2012 and in May 2012 the Supreme Court decided in British American Tobacco Group's favour, that claims submitted before 8 September 2003 can go back to 1973. A hearing took place in February 2012 at the ECJ on the questions referred from the Court of Appeal.

The ECJ judgment of 13 November 2012 confirms that the UK treatment of EU dividends was discriminatory and produces the same outcome for third country dividends from 1994 in certain circumstances. The judgment also confirms that the claim can cover dividends from all indirect as well as direct EU subsidiaries and also ACT paid by a superior holding company.

The detailed technical issues of the quantification mechanics of the claim were heard by the High Court during May and June 2014 and the judgment handed down on 18 December 2014. The High Court determined that in respect of issues concerning the calculation of unlawfully charged corporation tax and ACT, the law of restitution including the defence on change of position and questions concerning the calculation of overpaid interest, the approach of the British American Tobacco Group was broadly preferred. The conclusion reached by the High Court would, if upheld, produce an estimated receivable of £1.2 billion for British American Tobacco. Appeals on a majority of the issues have been made to the Court of Appeal, which is likely to hear the case in 2016.

During 2015, HMRC paid to the Group a gross amount of £1,224 million in two separate payments. The payments made by HMRC have been made without any admission of liability and are subject to refund were HMRC to succeed on appeal. The second payment in November 2015 followed the introduction of a new 45% tax on the interest component of restitution claims against HMRC. HMRC held back £261 million from the second payment contending that it represents the new 45% tax on that payment, leading to total cash received by the Group of £963 million. Actions challenging the legality of the 45% tax have been lodged by both the Group and other participants in the FII GLO.

Due to the uncertainty of the amounts and eventual outcome the Group has not recognised any impact in the Group Income Statement in the current or prior period. The receipt, net of the deduction by HMRC, is held as deferred income as disclosed in note 23. Any future recognition as income will be treated as an adjusting item, due to the size of the order, with interest accruing on the balance (£8 million in 2015) also treated as an adjusting item.

(c) Factors affecting the taxation charge

The taxation charge differs from the standard 20% (2014: 21%) rate of corporation tax in the UK. The major causes of this difference are listed below:

	2015		2014	
	£m	%	£m	%
Profit before tax	**5,855**		4,848	
Less: share of post-tax results of associates and joint ventures	**(1,236)**		(719)	
	4,619		4,129	
Tax at 20% (2014: 21%) on the above	**924**	**20.0**	867	21.0
Factors affecting the tax rate:				
Tax at standard rates other than UK corporation tax rate	**231**	**5.0**	236	5.7
Other national tax charges	**77**	**1.7**	69	1.7
Permanent differences	**(119)**	**(2.6)**	29	0.7
Overseas withholding taxes	**145**	**3.1**	157	3.8
Double taxation relief on UK profits	**(6)**	**(0.1)**	(9)	(0.2)
Unutilised tax losses	**32**	**0.7**	45	1.1
Adjustments in respect of prior periods	**7**	**0.2**	11	0.2
Deferred tax relating to changes in tax rates	**15**	**0.3**	(2)	—
Additional net deferred tax charges	**27**	**0.6**	52	1.2
	1,333	**28.9**	1,455	35.2

(d) Adjusting items included in taxation

IFRS requires entities to provide deferred taxation on the undistributed earnings of associates and joint ventures. The Group's share of the gain on the divestiture of intangibles and other assets by RAI to ITG Brands LLC, a subsidiary of Imperial Tobacco Group PLC, is £371 million. Given that the profit on this item is recognised as an adjusting item by the Group, the additional deferred tax charge of £22 million on the potential distribution of these undistributed earnings has also been treated as adjusting.

(e) Tax on adjusting items

In addition, the tax on adjusting items, separated between the different categories, as per note 7, amounted to £80 million (2014: £69 million). As described in note 4(b) the Group's investment of US$4.7 billion in cash in RAI has realised a deemed gain of US$931 million (£601 million). This gain is reflected as a permanent difference in note 6(c). The adjustment to the adjusted earnings per share (see note 7) also includes £3 million (2014: £5 million) in respect of the non-controlling interests' share of the adjusting items net of tax.

(f) Tax on items recognised directly in other comprehensive income

	2015	2014
	£m	£m
Current tax	**7**	17
Deferred tax	**(9)**	94
(Charged)/credited to other comprehensive income	**(2)**	111

The tax relating to each component of other comprehensive income is disclosed in note 20.

7 Earnings per share

Basic earnings per share are based on profit for the year attributable to ordinary shareholders of £4,290 million (2014: £3,115 million) and 1,858 million (2014: 1,864 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 1,863 million (2014: 1,870 million) to reflect the potential dilutive effect of employee share schemes.

	2015			2014		
	Earnings	Weighted average number of shares	Earnings per share	Earnings	Weighted average number of shares	Earnings per share
	£m	m	pence	£m	m	pence
Basic earnings per share	**4,290**	**1,858**	**230.9**	3,115	1,864	167.1
Share options	**—**	**5**	**(0.6)**	—	6	(0.5)
Diluted earnings per share	**4,290**	**1,863**	**230.3**	3,115	1,870	166.6

Earnings have been affected by a number of adjusting items, which are described in notes 3 to 6. To illustrate the impact of these items, an adjusted earnings per share calculation is shown below.

Adjusted earnings per share calculation

		Diluted				Basic			
		2015		2014		2015		2014	
	Notes	Earnings	Earnings per share	Earnings	Earnings per share	Earnings	Earnings per share	Earnings	Earnings per share
		£m	pence	£m	pence	£m	pence	£m	pence
Unadjusted earnings per share		**4,290**	**230.3**	3,115	166.6	**4,290**	**230.9**	3,115	167.1
Effect of restructuring and integration costs	3(e)	**367**	**19.7**	452	24.2	**367**	**19.7**	452	24.2
Tax and non-controlling interests on restructuring and integration costs		**(74)**	**(4.0)**	(67)	(3.6)	**(74)**	**(4.0)**	(67)	(3.6)
Effect of amortisation of trademarks and similar intangibles	3(f)	**65**	**3.5**	58	3.1	**65**	**3.5**	58	3.1
Tax on amortisation of trademarks and similar intangibles		**(9)**	**(0.5)**	(7)	(0.4)	**(9)**	**(0.5)**	(7)	(0.4)
Effect of Fox River	3(g)	**—**	**—**	(27)	(1.4)	**—**	**—**	(27)	(1.4)
Effect of Flintkote	3(h)	**3**	**0.2**	374	20.0	**3**	**0.2**	374	20.1
Effect of deemed gain related to investment in RAI	4(b)	**(601)**	**(32.3)**	—	—	**(601)**	**(32.3)**	—	—
Effect of additional deferred tax charge from gain on divestiture of assets by RAI to ITG	6(d)	**22**	**1.2**	—	—	**22**	**1.2**	—	—
Effect of interest on FII GLO settlement	4(b)	**8**	**0.4**	—	—	**8**	**0.4**	—	—
Effect of certain costs and fees related to the acquisition of non-controlling interests in Souza Cruz and investment in RAI	4(b)	**104**	**5.6**	—	—	**104**	**5.6**	—	—
Effect of associates' adjusting items net of tax	5(a)	**(293)**	**(15.7)**	(7)	(0.4)	**(293)**	**(15.8)**	(7)	(0.4)
Adjusted earnings per share		**3,882**	**208.4**	3,891	208.1	**3,882**	**208.9**	3,891	208.7

Headline earnings per share as required by the JSE Limited

The presentation of headline earnings per share, as an alternative measure of earnings per share, is mandated under the JSE Listing Requirements. It is calculated in accordance with Circular 2/2015 'Headline Earnings', as issued by the South African Institute of Chartered Accountants. There is no impact of the new circular on the prior year headline earnings per share.

	Diluted				Basic			
	2015		2014		2015		2014	
	Earnings	Earnings per share	Earnings	Earnings per share	Earnings	Earnings per share	Earnings	Earnings per share
	£m	pence	£m	pence	£m	pence	£m	pence
Unadjusted earnings per share	**4,290**	**230.3**	3,115	166.6	**4,290**	**230.9**	3,115	167.1
Effect of impairment of intangibles, property, plant and equipment, and assets held-for-sale	**27**	**1.4**	107	5.7	**27**	**1.4**	107	5.7
Tax and non-controlling interests on impairment of intangibles, and property, plant and equipment	**(6)**	**(0.3)**	(20)	(1.0)	**(6)**	**(0.3)**	(20)	(1.0)
Effect of gains on disposal of property, plant and equipment and held-for-sale assets	**(60)**	**(3.2)**	(34)	(1.9)	**(60)**	**(3.2)**	(34)	(1.8)
Tax and non-controlling interests on disposal of property, plant and equipment and held-for-sale assets	**19**	**1.0**	9	0.5	**19**	**1.0**	9	0.5
Effect of gains reclassified from the available-for-sale reserve	**(10)**	**(0.6)**	—	—	**(10)**	**(0.6)**	—	—
Tax and non-controlling interests on losses/(gains) reclassified from the available-for-sale reserve	**3**	**0.2**	—	—	**3**	**0.2**	—	—
Share of associates' impairment losses and non-current investments	**17**	**0.9**	—	—	**17**	**0.9**	—	—
Share of associates' gains on disposal of assets held-for-sale	**(371)**	**(19.9)**	—	—	**(371)**	**(19.9)**	—	—
Tax effect of associates' disposal of assets held-for-sale	**22**	**1.2**	—	—	**22**	**1.2**	—	—
Issue of shares and change in shareholding in associate	**(22)**	**(1.2)**	(14)	(0.8)	**(22)**	**(1.2)**	(14)	(0.8)
Headline earnings per share	**3,909**	**209.8**	3,163	169.1	**3,909**	**210.4**	3,163	169.7

An alternative measure of headline earnings per share has been presented below to take account of the effects of Fox River (note 3(g)), Flintkote (note 3(h)) and adjusting items in net finance (income)/costs (note 4(b)); this measure is in addition to and not mandated by the JSE Listing Requirements:

Headline earnings per share amended for adjusting items in net finance (income)/costs, Fox River and Flintkote	**3,415**	**183.3**	3,510	187.7	**3,415**	**183.9**	3,510	188.4

8 Dividends and other appropriations

	2015		2014	
	Pence per share	£m	Pence per share	£m
Ordinary shares				
Interim 2015 paid 30 September 2015	**49.4**	**908**		
2014 paid 30 September 2014			47.5	881
Final				
2014 paid 7 May 2015	**100.6**	**1,862**		
2013 paid 8 May 2014			97.4	1,831
	150.0	**2,770**	144.9	2,712

The Directors have recommended to shareholders a final dividend of 104.6 pence per share for the year ended 31 December 2015. If approved, this dividend will be paid to shareholders on 5 May 2016. This dividend is subject to approval by shareholders at the Annual General Meeting and therefore, in accordance with IAS 10 *Events After the Reporting Period*, it has not been included as a liability in these financial statements. The total estimated dividend to be paid is £1,943 million, which takes the total dividends declared in respect of 2015 to £2,851 million (2014: £2,747 million) representing 154.0 pence per share (2014: 148.1 pence per share).

9 Intangible assets

	Goodwill*	Computer software	Trademarks and similar intangibles	Assets in the course of development	Total
	£m	£m	£m	£m	£m
1 January 2015					
Cost	**9,842**	**735**	**844**	**305**	**11,726**
Accumulated amortisation and impairment		**(530)**	**(392)**		**(922)**
Net book value at 1 January 2015	**9,842**	**205**	**452**	**305**	**10,804**
Differences on exchange	**(681)**	**(3)**	**(36)**	**—**	**(720)**
Additions					
- internal development	**—**	**1**	**—**	**102**	**103**
- acquisitions (note 26)	**163**	**—**	**237**	**—**	**400**
- separately acquired	**—**	**2**	**—**	**—**	**2**
Reallocations	**—**	**225**	**2**	**(227)**	**—**
Amortisation charge	**—**	**(66)**	**(68)**	**—**	**(134)**
Impairment	**—**	**(10)**	**(4)**	**—**	**(14)**
Disposals	**—**	**(5)**	**—**	**—**	**(5)**
31 December 2015					
Cost	**9,324**	**918**	**1,015**	**180**	**11,437**
Accumulated amortisation and impairment		**(569)**	**(432)**		**(1,001)**
Net book value at 31 December 2015	**9,324**	**349**	**583**	**180**	**10,436**
1 January 2014					
Cost	10,249	631	891	283	12,054
Accumulated amortisation and impairment		(496)	(353)		(849)
Net book value at 1 January 2014	10,249	135	538	283	11,205
Differences on exchange	(407)	(3)	(31)	—	(441)
Additions					
- internal development	—	16	—	143	159
- separately acquired	—	4	3	—	7
Reallocations	—	121	—	(121)	—
Amortisation charge	—	(56)	(58)	—	(114)
Impairment	—	(12)	—	—	(12)
31 December 2014					
Cost	9,842	735	844	305	11,726
Accumulated amortisation and impairment		(530)	(392)		(922)
Net book value at 31 December 2014	9,842	205	452	305	10,804

* The cost of goodwill is shown net of impairment charges made in prior years.

Included in computer software and assets in the course of development are internally developed assets with a carrying value of £517 million (2014: £493 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.

Included in the net book value of trademarks and similar intangibles are trademarks relating to the acquisition of TDR d.o.o. £144 million, Sudan £34 million, Chic Group £45 million, Skandinavisk Tobakskompagni (ST) £229 million (2014: £262 million), Tekel £19 million (2014: £25 million), Bentoel £19 million (2014: £30 million) and Protabaco £54 million (2014: £72 million) and intellectual property of £nil (2014: £13 million) relating to the acquisition of CN Creative Limited in 2012.

The Group has future contractual commitments of £15 million (2014: £10 million) related to intangible assets.

Impairment testing for intangible assets with indefinite lives including goodwill

Goodwill of £9,324 million (2014: £9,842 million) is included in intangible assets in the Group Balance Sheet of which the following are the significant acquisitions: Rothmans Group £4,131 million (2014: £4,384 million); Imperial Tobacco Canada £1,964 million (2014: £2,223 million); ETI (Italy) £1,216 million (2014: £1,280 million) and ST (principally Scandinavia) £913 million (2014: £963 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 UK and operations in Asia-Pacific.

In 2015 and 2014, goodwill was allocated for impairment testing purposes to 14 individual cash-generating units — five in Asia-Pacific, five in the Americas, two in Western Europe and two in EEMEA.

The carrying amounts of goodwill allocated to the cash-generating units of Canada £1,964 million (2014: £2,223 million), Western Europe (includes Rothmans and other acquisitions) £3,249 million (2014: £3,388 million), Eastern Europe (includes Rothmans and other acquisitions) £832 million (2014: £851 million), South Africa £485 million (2014: £614 million), Australia (includes Rothmans and other acquisitions) £661 million (2014: £703 million), Singapore £511 million (2014: £517 million) and Malaysia £372 million (2014: £432 million) are considered significant in comparison with the total carrying amount of goodwill.

The recoverable amounts of all cash-generating units have been determined on a value-in-use basis. The key assumptions for the recoverable amounts of all units are the budgeted volumes, operating margins and long-term growth rates, which directly impact the cash flows, and the discount rates used in the calculation. 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. The long-term growth rates and discount rates have been applied to the budgeted cash flows of each cash-generating unit. These cash flows have been determined by local management based on experience, specific market and brand trends, pricing expectations and costs, and have been endorsed by Group management as part of the consolidated Group budget.

The valuations use cash flows based on detailed financial budgets prepared by management covering a one-year period, with growth in year 2 of 5% (2014: 5%). Cash flows for the years 3 to 10 are extrapolated from year 2 cash flows of each relevant operating unit at 4% (2014: 4%) per annum, including 1% (2014: 1%) inflation, where after a total growth rate of 2% (2014: 2%) per annum (including 2% (2014: 2%) inflation) has been assumed. The extrapolated growth rates are considered conservative given the Group's history of profit and cash growth, its well balanced portfolio of brands and the industry in which it operates. The long-term real growth does not exceed the expected long-term average growth rate for the combined markets in which the cash-generating units operate. In some instances, such as recent acquisitions, start-up ventures or in other specific cases, the valuation is expanded to reflect the medium-term plan of the country or market management, spanning five years or beyond.

Pre-tax discount rates of between 7.2% and 14.7% (2014: 7.2% to 15.0%) were used, based on the Group's weighted average cost of capital, together with any premium applicable for economic and political risks.

The pre-tax discount rates used for the cash-generating units which are significant in comparison with the total carrying amount of goodwill are 8.5% for Canada (2014: 8.5%), 8.6% for Western Europe (2014: 8.6%), 8.5% for Eastern Europe (2014: 8.5%), 9.6% for South Africa (2014: 9.6%), 8.6% for Australia (2014: 8.6%), 7.2% for Singapore (2014: 7.2%) and 8.7% for Malaysia (2014: 8.7%).

If discounted cash flows for cash-generating units should fall by 10%, or the discount rate was increased at a post-tax rate of 1%, there would be no impairment.

10 Property, plant and equipment

	Freehold property	Leasehold property	Plant and equipment	Assets in the course of construction	Total
	£m	£m	£m	£m	£m
1 January 2015					
Cost	**998**	**260**	**4,109**	**570**	**5,937**
Accumulated depreciation and impairment	**(343)**	**(132)**	**(2,439)**	**(19)**	**(2,933)**
Net book value at 1 January 2015	**655**	**128**	**1,670**	**551**	**3,004**
Differences on exchange	**(62)**	**—**	**(125)**	**(62)**	**(249)**
Additions					
- acquisitions (note 26)	**76**	**—**	**23**	**4**	**103**
- separately acquired	**6**	**7**	**129**	**353**	**495**
Reallocations	**23**	**9**	**211**	**(243)**	**—**
Depreciation	**(19)**	**(10)**	**(242)**	**—**	**(271)**
Impairment	**—**	**(2)**	**(17)**	**7**	**(12)**
Disposals	**(15)**	**(2)**	**(15)**	**(8)**	**(40)**
Net reclassifications as held-for-sale	**(8)**	**—**	**(1)**	**—**	**(9)**
31 December 2015					
Cost	**944**	**256**	**3,976**	**617**	**5,793**
Accumulated depreciation and impairment	**(288)**	**(126)**	**(2,343)**	**(15)**	**(2,772)**
Net book value at 31 December 2015	**656**	**130**	**1,633**	**602**	**3,021**
1 January 2014					
Cost	1,034	258	4,257	527	6,076
Accumulated depreciation and impairment	(325)	(123)	(2,460)	(12)	(2,920)
Net book value at 1 January 2014	709	135	1,797	515	3,156
Differences on exchange	(45)	(1)	(138)	(33)	(217)
Additions	9	1	74	414	498
Reallocations	55	12	274	(341)	—
Depreciation	(20)	(9)	(278)	—	(307)
Impairment	(40)	(8)	(36)	(3)	(87)
Disposals	(13)	(2)	(12)	(1)	(28)
Net reclassifications as held-for-sale	—	—	(11)	—	(11)
31 December 2014					
Cost	998	260	4,109	570	5,937
Accumulated depreciation and impairment	(343)	(132)	(2,439)	(19)	(2,933)
Net book value at 31 December 2014	655	128	1,670	551	3,004
Assets held under finance leases					
31 December 2015					
Cost		**4**	**29**	**1**	**34**
Accumulated depreciation and impairment		**—**	**(10)**	**—**	**(10)**
Net book value at 31 December 2015		**4**	**19**	**1**	**24**
31 December 2014					
Cost		—	17	—	17
Accumulated depreciation and impairment		—	(8)	—	(8)
Net book value at 31 December 2014		—	9	—	9

The Group’s finance lease arrangements relate principally to the lease of vehicles and tobacco vending machines by the Group’s subsidiaries in Canada and Japan respectively. In 2014, the Group’s finance lease arrangements related principally to the lease of vehicles and tobacco vending machines by the Group’s subsidiaries in Pakistan and Japan respectively. Assets held under finance leases are secured under finance lease obligations included in note 21.

As explained in note 12, contributions to the British American Tobacco UK Pension Fund are secured by a charge over the Group's Head Office (Globe House). Globe House is included in freehold property above with a carrying value of £189 million (2014: £191 million).

	2015	2014
	£m	£m
Cost of freehold land within freehold property on which no depreciation is provided	**193**	200
Leasehold property comprises		
- net book value of long leasehold	**119**	113
- net book value of short leasehold	**11**	15
	130	128
Contracts placed for future expenditure	**71**	121

11 Investments in associates and joint ventures

	2015	2014
	£m	£m
1 January	**2,400**	2,299
Total comprehensive income (note 5)	**1,576**	723
Dividends (note 5)	**(640)**	(518)
Share buy-backs (note 25(d))	**—**	(94)
Additions	**3,628**	—
Other equity movements	**(26)**	(10)
31 December	**6,938**	2,400
Non-current assets	**14,800**	4,070
Current assets	**2,818**	1,798
Non-current liabilities	**(8,692)**	(2,099)
Current liabilities	**(1,988)**	(1,369)
	6,938	2,400
Reynolds American Inc. (Group's share of the market value is £18,850 million (2014: £9,205 million))	**5,749**	1,361
ITC Ltd. (Group's share of the market value is £8,112 million (2014: £9,001 million))	**1,136**	991
Other listed associates (Group's share of the market value is £86 million (2014: £98 million))	**14**	13
Unlisted associates	**39**	35
	6,938	2,400

The principal associate undertakings of the Group are Reynolds American Inc. (RAI) and ITC Ltd. (ITC) as shown under principal associate undertakings.

Reynolds American Inc.

	2015	2014
	£m	£m
Non-current assets	**28,666**	4,481
Current assets	**4,242**	2,193
Non-current liabilities	**(20,430)**	(4,838)
Current liabilities	**(3,459)**	(2,162)
	9,019	(326)
Group's share of Reynolds American Inc. (42.2%)	**3,804**	(137)
Goodwill	**1,945**	1,498
Total Group's share of Reynolds American Inc.	**5,749**	1,361

On 30 July 2004, the Group completed the agreement to combine the US domestic business of Brown & Williamson (B&W), one of its subsidiaries, with R.J. Reynolds. This combination resulted in the formation of RAI, which was 58% owned by R.J. Reynolds' shareholders and 42% owned by the Group. The Group has concluded that it does not have de facto control of RAI because of the operation of the governance agreement

between the Group and RAI which ensures that the Group does not have the practical ability to direct the relevant activities of RAI; in particular, the Group cannot nominate more than five of the Directors (out of 13 or proportionally less if there are less than 13 Directors) unless it owns 100% of RAI or some other party owns more than 50%. In addition, there are no other contractual arrangements which would give the Group the ability to direct RAI's operations. Manufacturing and cooperation agreements between RAI and the Group have been agreed on an arm's length basis (see note 29).

On 12 June 2015, RAI completed its acquisition of Lorillard, Inc. (Lorillard) and related divestiture transactions to ITG Brands LLC, a subsidiary of Imperial Tobacco Group PLC, after receiving the required regulatory approval. At the same time, the intention of which was announced on 15 July 2014, the Group invested US$4.7 billion (£3.0 billion) of cash in RAI to maintain its 42% equity position in the enlarged business.

The Group has recognised a deemed gain of US$931 million (£601 million), as part of the cost of investment. This has arisen as the contract to acquire shares is deemed to be a financial instrument and was fair valued through the profit and loss, in compliance with IAS 39 *Financial Instruments: Recognition and Measurement*. This has been treated as an adjusting item, in line with the Group's policy as described in note 4. Goodwill of US$529 million (£336 million) has also been recognised, being the difference between the Group's share of the net assets acquired by RAI, and the deemed fair value of the consideration paid.

RAI recognised a gain on divestiture of assets of US$3,288 million. The Group's share of this net gain amounted to £371 million (net of tax). This has been treated as an adjusting item, in line with the Group's policy, as described in note 5.

The Group's share of RAI includes £427 million (2014: £472 million) of trademarks arising from the RAI transaction in 2004. The Group's share of non-current assets also includes £708 million (2014: £667 million) of goodwill and £327 million (2014: £308 million) of trademarks arising from the acquisition of Conwood by RAI in 2006. In addition, the Group's share of non-current assets includes £7,784 million of trademarks arising from the acquisition of Lorillard by RAI in 2015.

The Group's share of the RAI results for the year to 31 December 2015 includes £55 million (2014: £46 million) in respect of external legal fees and other external product liability defence costs.

Details of the Group's contingent liabilities are set out in note 30. In addition to US litigation involving Group companies, which is covered by the R.J. Reynolds Tobacco Company (RJRT) indemnity referred to in note 30, RAI group companies are named in litigation which does not involve Group companies. While it is impossible to be certain of the outcome of any particular case or of the amount of any possible adverse verdict, it is not impossible that the results of operations or cash flows of RAI, in particular quarterly or annual periods, could be materially affected by this and by the final outcome of any particular litigation. However, having regard to the contingent liability disclosures on litigation made by RAI in its public financial reports, the Directors are satisfied with the carrying value included above for RAI.

ITC Ltd.

ITC prepares accounts on a quarterly basis with a 31 March year-end. As permitted by IAS 28 Investments in Associates and Joint Ventures, results up to 30 September 2015 have been used in applying the equity method. This is driven by the availability of information at the half year, to be consistent with the treatment in the Group's interim accounts. Any further information available after the date used for reporting purposes is reviewed and any material items adjusted for in the final results. The latest published information available is at 31 December 2015.

	2015	**2014**
	£m	**£m**
Non-current assets	**2,432**	2,201
Current assets	**3,044**	2,713
Non-current liabilities	**(250)**	(212)
Current liabilities	**(1,447)**	(1,428)
	3,779	3,274
Group's share of ITC Ltd. (2015: 30.06% (2014: 30.26%))	**1,136**	991

Additional information on associates is provided in the 'Group Companies and Undertakings' section to the Annual Report on pages 206 to 212.

12 Retirement benefit schemes

The Group's subsidiary undertakings operate around 170 retirement benefit arrangements worldwide. The majority of scheme members belong to defined benefit schemes, most of which are funded externally and many of which are closed to new entrants. The Group also operates a number of defined contribution schemes.

The liabilities arising in the defined benefit schemes are determined in accordance with the advice of independent, professionally qualified actuaries, using the projected unit credit method. All schemes are formally valued at least every three years.

The principal schemes are in the UK, Germany, Canada, the Netherlands and Switzerland. Together schemes in these territories account for over 85% of the total obligations of the Group's defined benefit schemes. These obligations consist mainly of final salary pension schemes which provide benefits to members in the form of a guaranteed level of pension payable for life. The level of benefits provided depends on members' length of service and their salary in the final years leading up to retirement. As a result of regulatory changes, with effect from 1 January 2015, the schemes in the Netherlands now accrue benefits based on lifetime average salaries.

In addition, the Group operates several healthcare benefit schemes, of which the most significant are in Canada. The liabilities in respect of healthcare benefits are also assessed by qualified independent actuaries, applying the projected unit credit method.

All of these arrangements, including funded schemes where formal trusts or equivalents are required, have been developed and are operated in accordance with local practices and regulations where applicable in the countries concerned. For example, in the UK, the main pension scheme is the British American Tobacco UK Pension Fund, which is established under trust law and has a corporate trustee that is required to run the scheme in accordance with the Scheme's Trust Deed and Rules and to comply with the Pension Scheme Act 1993, Pensions Act 1995, Pension Act 2004 and all the relevant legislation.

Responsibility for the governance of the schemes, including investment decisions and contribution schedules, lies with the trustees. The trustees for each arrangement will usually consist of representatives appointed by both the sponsoring company and the beneficiaries.

The majority of schemes are subject to local regulation regarding funding deficits. Contributions to defined benefit schemes are determined after consultation with the respective trustees and actuaries of the individual externally funded schemes and after taking into account regulatory requirements.

Contributions to the British American Tobacco UK Pension Fund have been agreed with the Trustee as part of a recovery plan to include £30 million a year to cover ongoing service costs and additional contributions to eliminate a funding shortfall. Additional contributions were £148 million in 2015 and £140 million in 2014 and are planned to be £78 million in each of 2016, 2017 and 2018. These contributions will be used to achieve the statutory funding objective and thereafter to support attaining a lower risk investment strategy (noted below) and may be subject to renegotiation, dependent on funding levels. Total contributions payable are secured by a charge over the Group's Head Office (Globe House) up to a maximum of £150 million. The charge would be triggered in the event that the Group defaults on agreed contributions due to the Fund or if an insolvency event occurs with respect to the UK entity responsible for making the payments. The charge is due to be released in 2039 but may be released earlier by negotiation or if the assets of the Fund are sufficient to achieve certain funding levels. Under the rules of the scheme, any future surplus would be returnable to the Group by refund at the end of the life of the scheme. The funding commitment is therefore not considered onerous and in accordance with IFRIC 14 no additional liabilities have been recognised in respect of this commitment.

Payments made to pensioners by the operating companies in Germany, net of income on scheme assets, are deemed to be company contributions to the Contractual Trust Arrangements and are anticipated to be around £33 million in 2016 and then £31 million per annum for the next following four years. Contributions to pension schemes in Canada, the Netherlands and Switzerland in total are anticipated to be around £19 million in 2016 and then £11 million per annum for the next following four years. Group contributions to pension schemes in 2016 are expected to be £173 million in total compared to £262 million in 2015.

The majority of benefit payments are from trustee administered funds; however, there are also a number of unfunded schemes where the sponsoring company meets the benefit payment obligation as it falls due. For unfunded schemes in the UK and Canada, 33% of the liabilities reported at year-end are expected to be settled by the Group within 10 years, 28% between 10 and 20 years, 20% between 20 and 30 years, and 19% thereafter.

The funded arrangements in the Group have policies on investment management, including strategies over a preferred long-term investment profile, and schemes in certain territories including Canada and the Netherlands

manage their bond portfolios to match the weighted average duration of scheme liabilities. In addition, the main scheme in the UK has a target investment strategy such that, by 31 December 2018, the scheme will have moved to 20% return-seeking assets and 80% risk-reducing assets. Investments are diversified by type of investment, by investment sector, and where appropriate by country.

Through its defined benefit pension schemes and healthcare schemes, the Group is exposed to a number of risks, including:

Asset volatility

The plan liabilities are calculated using discount rates set by reference to bond yields; if plan assets underperform this yield e.g. due to stock market volatility, this will create a deficit. However, most schemes hold a proportion of assets which are expected to outperform bonds in the long term, and the majority of schemes by value are subject to local regulation regarding funding deficits.

Changes in bond yields

A decrease in corporate bond yields will increase scheme liabilities, although this will be partially offset by an increase in the value of the schemes' bond holdings or other hedging instruments.

Inflation risk

Some of the Group's pension obligations are linked to inflation and higher inflation will lead to higher liabilities, although, in most cases, caps on the level of inflationary increases are in place in the scheme rules, while some assets and derivatives provide specific inflation protection.

Life expectancy

The majority of the schemes' obligations are to provide benefits for the life of the member, so increases in life expectancy will result in an increase in the plans' liabilities. Assumptions regarding mortality and mortality improvements are regularly reviewed in line with actuarial tables and scheme specific experience.

The amounts recognised in the Group Balance Sheet are determined as follows:

	Pension schemes		Healthcare schemes		Total	
	2015	**2014**	**2015**	**2014**	**2015**	**2014**
	£m	**£m**	**£m**	**£m**	**£m**	**£m**
Present value of funded scheme liabilities	**(5,944)**	(6,594)	**(12)**	(15)	**(5,956)**	(6,609)
Fair value of funded scheme assets	**6,076**	6,253	**10**	13	**6,086**	6,266
	132	(341)	**(2)**	(2)	**130**	(343)
Unrecognised funded scheme surpluses	**(11)**	(13)	**—**	—	**(11)**	(13)
	121	(354)	**(2)**	(2)	**119**	(356)
Present value of unfunded scheme liabilities	**(276)**	(287)	**(88)**	(98)	**(364)**	(385)
	(155)	(641)	**(90)**	(100)	**(245)**	(741)
The above net liability is recognised in the Group Balance Sheet as follows:						
- retirement benefit scheme liabilities	**(563)**	(681)	**(90)**	(100)	**(653)**	(781)
- retirement benefit scheme assets	**408**	40	**—**	—	**408**	40
	(155)	(641)	**(90)**	(100)	**(245)**	(741)

The net liabilities of funded pension schemes by territory are as follows:

	Liabilities		Assets		Total	
	2015	**2014**	**2015**	**2014**	**2015**	**2014**
	£m	**£m**	**£m**	**£m**	**£m**	**£m**
- UK	**(2,995)**	(3,217)	**3,291**	3,198	**296**	(19)
- Germany	**(822)**	(929)	**704**	733	**(118)**	(196)
- Canada	**(654)**	(753)	**661**	762	**7**	9
- Netherlands	**(588)**	(704)	**641**	685	**53**	(19)
- Switzerland	**(347)**	(349)	**278**	272	**(69)**	(77)
- Rest of Group	**(538)**	(642)	**501**	603	**(37)**	(39)
Funded schemes	**(5,944)**	(6,594)	**6,076**	6,253	**132**	(341)

Of the Group's unfunded pension schemes 62% (2014: 57%) relate to arrangements in the UK, while 79% (2014: 81%) of the Group's unfunded healthcare arrangements relate to arrangements in Canada.

The amounts recognised in the Group Income Statement are as follows:

	Pension schemes		Healthcare schemes		Total	
	2015	**2014**	**2015**	**2014**	**2015**	**2014**
	£m	**£m**	**£m**	**£m**	**£m**	**£m**
Defined benefit schemes						
Service cost						
- current service cost	**85**	81	**1**	1	**86**	82
- past service cost	**(10)**	(2)	**—**	(3)	**(10)**	(5)
Net interest on the net defined benefit liability						
- interest on scheme liabilities	**215**	261	**5**	6	**220**	267
- interest on scheme assets	**(201)**	(252)	**(1)**	(1)	**(202)**	(253)
- interest on unrecognised funded scheme surpluses	**1**	1	**—**	—	**1**	1
	90	89	**5**	3	**95**	92
Defined contribution schemes	**43**	40	**—**	—	**43**	40
Total amount recognised in the Income Statement (note 3(a))	**133**	129	**5**	3	**138**	132

The above charges are recognised within employee benefit costs in note 3(a) and include a charge of £16 million in 2015 (2014: £4 million charge) in respect of settlements, past service costs and defined contribution costs reported as part of the restructuring costs charged in arriving at profit from operations (see note 3(e)).

The amounts recognised in other comprehensive income in respect of actuarial gains and losses of subsidiaries are as follows:

	Pension schemes		Healthcare schemes		Total	
	2015	**2014**	**2015**	**2014**	**2015**	**2014**
	£m	**£m**	**£m**	**£m**	**£m**	**£m**
Actuarial gains/(losses) on scheme liabilities	**378**	(878)	**(1)**	(6)	**377**	(884)
Actuarial (losses)/gains on scheme assets	**(94)**	456	**—**	—	**(94)**	456
Net actuarial gains/(losses) in other comprehensive income (note 20)	**284**	(422)	**(1)**	(6)	**283**	(428)

The amounts recognised in other comprehensive income in respect of surplus restrictions of subsidiaries are as follows:

	Pension schemes		Healthcare schemes		Total	
	2015	**2014**	**2015**	**2014**	**2015**	**2014**
	£m	**£m**	**£m**	**£m**	**£m**	**£m**
Movements in the year (note 20)	**—**	7	**—**	—	**—**	7

The movements in scheme liabilities are as follows:

	Pension schemes		Healthcare schemes		Total	
	2015	2014	2015	2014	2015	2014
	£m	£m	£m	£m	£m	£m
Present value at 1 January	**6,881**	6,144	**113**	114	**6,994**	6,258
Differences on exchange	**(215)**	(142)	**(13)**	(4)	**(228)**	(146)
Current service cost	**86**	80	**1**	1	**87**	81
Past service cost	**(9)**	(2)	**—**	(3)	**(9)**	(5)
Settlements	**(20)**	—	**—**	—	**(20)**	—
Interest on scheme liabilities	**211**	258	**4**	6	**215**	264
Contributions by scheme members	**3**	4	**—**	—	**3**	4
Benefits paid	**(339)**	(339)	**(6)**	(7)	**(345)**	(346)
Actuarial (gains)/losses	**(378)**	878	**1**	6	**(377)**	884
Present value at 31 December	**6,220**	6,881	**100**	113	**6,320**	6,994
Scheme liabilities by scheme membership:						
Active members	**1,139**	1,354	**20**	23	**1,159**	1,377
Deferred members	**900**	1,080	**2**	8	**902**	1,088
Retired members	**4,181**	4,447	**78**	82	**4,259**	4,529
Present value at 31 December	**6,220**	6,881	**100**	113	**6,320**	6,994

Approximately 95% of scheme liabilities in both years relate to guaranteed benefits.

Actuarial (gains)/losses shown above can be analysed as follows:

	Pension schemes		Healthcare schemes		Total	
	2015	2014	2015	2014	2015	2014
	£m	£m	£m	£m	£m	£m
Actuarial (gains)/losses:						
- arising from changes in demographic assumptions	**13**	120	**—**	3	**13**	123
- arising from changes in financial assumptions	**(335)**	766	**1**	6	**(334)**	772
Experience gains	**(56)**	(8)	**—**	(3)	**(56)**	(11)
Total	**(378)**	878	**1**	6	**(377)**	884

Changes in financial assumptions principally relate to discount rate movements in both years.

The movements in funded scheme assets are as follows:

	Pension schemes		Healthcare schemes		Total	
	2015	2014	2015	2014	2015	2014
	£m	£m	£m	£m	£m	£m
Fair value of scheme assets at 1 January	**6,253**	5,767	**13**	13	**6,266**	5,780
Differences on exchange	**(209)**	(141)	**(3)**	(1)	**(212)**	(142)
Settlements	**(19)**	—	**—**	—	**(19)**	—
Interest on scheme assets	**197**	249	**1**	1	**198**	250
Company contributions	**262**	241	**—**	—	**262**	241
Contributions by scheme members	**4**	4	**—**	—	**4**	4
Benefits paid	**(318)**	(323)	**(1)**	—	**(319)**	(323)
Actuarial (losses)/gains	**(94)**	456	**—**	—	**(94)**	456
Fair value of scheme assets at 31 December	**6,076**	6,253	**10**	13	**6,086**	6,266

Fair value of scheme assets by category:

	Pension schemes		Healthcare schemes		Total	
	2015	2014	2015	2014	2015	2014
	£m	£m	£m	£m	£m	£m
Equities — listed	**1,559**	1,759	**4**	5	**1,563**	1,764
Equities — unlisted	**557**	533	**—**	—	**557**	533
Bonds — listed	**3,092**	2,812	**3**	4	**3,095**	2,816
Bonds — unlisted	**43**	34	**—**	—	**43**	34
Other assets — listed	**94**	84	**3**	4	**97**	88
Other assets — unlisted	**731**	1,031	**—**	—	**731**	1,031
Fair value of scheme assets at 31 December	**6,076**	6,253	**10**	13	**6,086**	6,266

Scheme assets have been diversified into equities, bonds and other assets and are typically invested via fund investment managers into both pooled and segregated mandates of listed and unlisted equities and bonds. In addition certain scheme assets, including a portion of the assets held in the main UK pension scheme, are further diversified by investing in equities listed on foreign stock exchanges via investment funds. In the above analysis investments via equity-based investment funds are shown under listed equities, and investments via bond-based investment funds are shown under listed bonds.

In Jamaica, a pension scheme holds shares in Carreras Limited (a Group subsidiary) with a fair value of £1 million (2014: £1 million). The shares are listed on the Jamaica stock exchange.

Other assets include cash and other deposits, derivatives and other hedges (including liability driven investments funds and inflation opportunity funds), recoverable taxes, reinsurance contracts, infrastructure investments and investment property.

The actuarial gains and losses in both years principally relate to movements in the fair values of scheme assets and actual returns are stated net of applicable taxes and fund management fees.

	Pension schemes		Healthcare schemes		Total	
	2015	2014	2015	2014	2015	2014
	£m	£m	£m	£m	£m	£m
Actual return on scheme assets	**103**	705	**1**	1	**104**	706

The movements in the unrecognised scheme surpluses, recognised in other comprehensive income, are as follows:

	Pension schemes		Healthcare schemes		Total	
	2015	2014	2015	2014	2015	2014
	£m	£m	£m	£m	£m	£m
Unrecognised funded scheme surpluses at 1 January	**(13)**	(19)	**—**	—	**(13)**	(19)
Differences on exchange	**3**	—	**—**	—	**3**	—
Interest on unrecognised funded scheme surpluses	**(1)**	(1)	**—**	—	**(1)**	(1)
Movement in year (note 20)	**—**	7	**—**	—	**—**	7
Unrecognised funded scheme surpluses at 31 December	**(11)**	(13)	**—**	—	**(11)**	(13)

The principal actuarial assumptions (weighted to reflect individual scheme differences) used in the following principal countries are shown below. In both years, discount rates are determined by reference to normal yields on high quality corporate bonds at the balance sheet date. For countries where there is not a deep market in such corporate bonds, the yield on government bonds is used.

	UK	Germany	Canada	Netherlands	Switzerland
	%	%	%	%	%
31 December 2015					
Rate of increase in salaries	**4.6**	**2.3**	**3.3**	**2.0**	**1.3**
Rate of increase in pensions in payment	**3.1**	**1.5**	**Nil**	**1.1**	**Nil**
Rate of increase in deferred pensions	**2.3**	**Nil**	**Nil**	**1.1**	**—**
Discount rate	**3.8**	**2.3**	**3.8**	**2.5**	**0.7**
General inflation	**3.1**	**1.5**	**2.3**	**2.0**	**0.9**

	UK years	Germany years	Canada years	Netherlands years	Switzerland years
31 December 2015					
Weighted average duration of liabilities	**16.9**	**13.0**	**11.1**	**17.9**	**14.6**

For healthcare inflation in Canada, the assumption is 4.5%. For the remaining pension schemes, typical assumptions are that real salary increases will be from 0% to 6.5% per annum and discount rates will be from 0% to 7.7% above inflation. Pension increases, where allowed for, are generally assumed to be in line with inflation.

	UK %	Germany %	Canada %	Netherlands %	Switzerland %
31 December 2014					
Rate of increase in salaries	4.5	2.5	3.3	2.0	1.5
Rate of increase in pensions in payment	3.0	1.8	Nil	1.6	Nil
Rate of increase in deferred pensions	2.5	Nil	Nil	1.6	—
Discount rate	3.4	1.9	3.8	2.0	1.1
General inflation	3.0	1.8	2.3	2.0	Nil

	UK years	Germany years	Canada years	Netherlands years	Switzerland years
31 December 2014					
Weighted average duration of liabilities	17.2	14.0	11.2	19.4	14.8

For healthcare inflation in Canada, the assumption was 4.0%. For the remaining pension schemes, typical assumptions were that real salary increases would be from 0% to 4.5% per annum and discount rates would be from 0% to 5.9% above inflation. Pension increases, where allowed for, were generally assumed to be in line with inflation.

Mortality assumptions are subject to regular review. The principal schemes used the following tables for both years:

UK	91.5% S1NA (year of birth) table with the Continuous Mortality Investigation (2013) model with a 1.75% long-term improvement rate
Germany	Heubeck tables 2005G
Canada	CPM-2014 Private Table
Netherlands	AG Prognosetafel 2014
Switzerland	LPP 2010 tables

Based on the above, the weighted average life expectancy, in years, for mortality tables used to determine benefit obligations is as follows:

	UK		Germany		Canada		Netherlands		Switzerland	
	Male	Female	Male	Female	Male	Female	Male	Female	Male	Female
31 December 2015										
Member age 65 (current life expectancy)	**23.7**	**26.3**	**19.0**	**23.1**	**21.2**	**23.7**	**20.9**	**24.8**	**21.5**	**24.0**
Member age 45 (life expectancy at age 65)	**26.4**	**29.1**	**21.7**	**25.6**	**22.3**	**24.7**	**23.4**	**26.8**	**23.3**	**25.7**
31 December 2014										
Member age 65 (current life expectancy)	23.6	26.1	18.9	23.0	20.8	23.3	20.8	24.7	21.4	23.9
Member age 45 (life expectancy at age 65)	26.3	28.9	21.6	25.5	22.0	24.3	23.3	26.7	23.2	25.6

Valuation of retirement benefit schemes involves judgements about uncertain future events. Sensitivities in respect of the key assumptions used to measure the principal pension schemes as at 31 December 2015 are set out below. These sensitivities show the hypothetical impact of a change in each of the listed assumptions in isolation, with the exception of the sensitivity to inflation which incorporates the impact of certain correlating assumptions such as salary increases. While each of these sensitivities holds all other assumptions constant, in practice such assumptions rarely change in isolation, while asset values also change, and the impacts may offset to some extent.

	1 year increase £m	1 year decrease £m	0.25 percentage point increase £m	0.25 percentage point decrease £m
Average life expectancy — increase/(decrease) of scheme liabilities	**170**	**(171)**		
Rate of inflation — increase/(decrease) of scheme liabilities			**182**	**(171)**
Discount rate — (decrease)/increase of scheme liabilities			**(198)**	**210**

A one percentage point increase in healthcare inflation would increase healthcare scheme liabilities by £14 million, and a one percentage point decrease would decrease liabilities by £11 million. The income statement effect of this change in assumption is not material.

13 Deferred tax

Deferred tax assets comprise:

	Stock relief	Excess of depreciation over capital allowances	Tax losses	Retirement benefits	Fair value losses/ (gains)	Other temporary differences	Total
	£m	£m	£m	£m	£m	£m	£m
At 1 January 2015	**31**	**34**	**46**	**155**	**62**	**138**	**466**
Differences on exchange	**(1)**	**1**	**(9)**	**(8)**	**3**	**(22)**	**(36)**
Credited/(charged) to the Income Statement	**3**	**(2)**	**16**	**(46)**	**(6)**	**39**	**4**
(Charged)/credited to other comprehensive income	**—**	**—**	**—**	**(4)**	**1**	**—**	**(3)**
Subsidiaries acquired (note 26)	**—**	**—**	**—**	**—**	**—**	**3**	**3**
At 31 December 2015	**33**	**33**	**53**	**97**	**60**	**158**	**434**
At 1 January 2014	46	34	67	104	—	157	408
Differences on exchange	(5)	(2)	(4)	(7)	—	(5)	(23)
(Charged)/credited to the Income Statement	(10)	2	(17)	(7)	62	(14)	16
Credited to other comprehensive income	—	—	—	65	—	—	65
At 31 December 2014	31	34	46	155	62	138	466

Deferred tax liabilities comprise:

	Stock relief	Excess of capital allowances over depreciation	Undistributed earnings of associates and subsidiaries	Retirement benefits	Fair value (losses)/ gains	Other temporary differences	Total
	£m	£m	£m	£m	£m	£m	£m
At 1 January 2015	**8**	**176**	**204**	**76**	**23**	**163**	**650**
Differences on exchange	**2**	**(11)**	**(4)**	**(6)**	**—**	**(13)**	**(32)**
(Credited)/charged to the Income Statement	**(7)**	**—**	**55**	**(40)**	**7**	**(7)**	**8**
Charged/(credited) to other comprehensive income	**—**	**—**	**—**	**19**	**(13)**	**—**	**6**
Subsidiaries acquired (note 26)	**—**	**—**	**—**	**—**	**—**	**39**	**39**
At 31 December 2015	**3**	**165**	**255**	**49**	**17**	**182**	**671**
At 1 January 2014	11	164	181	105	37	176	674
Differences on exchange	2	(5)	6	(8)	—	(11)	(16)
(Credited)/charged to the Income Statement	(5)	17	12	2	—	(5)	21
Charged/(credited) to other comprehensive income	—	—	5	(23)	(14)	3	(29)
At 31 December 2014	8	176	204	76	23	163	650

	2015	2014
	£m	£m
Net deferred tax liabilities	**237**	184

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.

	2015 £m	2014 £m
Deferred tax assets	**(326)**	(311)
Deferred tax liabilities	**563**	495
	237	184

Deferred tax expected to be recovered within 12 months:

	2015 £m	2014 £m
Deferred tax assets	**(133)**	(112)
Deferred tax liabilities	**348**	364
	215	252

At the balance sheet date, the Group has unused tax losses of £804 million (2014: £704 million) which have no expiry date and unused tax losses of £698 million (2014: £642 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 £737 million (2014: £971 million), which have no expiry date and £173 million (2014: £193 million), which will expire within the next 10 years.

At the balance sheet date, the Group has unused tax credits of £80 million (2014: £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 (2014: £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

	2015 £m	2014 £m
Trade receivables	**2,355**	2,071
Loans and other receivables	**984**	697
Prepayments and accrued income	**175**	153
	3,514	2,921
Current	**3,266**	2,768
Non-current	**248**	153
	3,514	2,921

Included in loans and other receivables, is £55 million in respect of payments made by a Group subsidiary in relation to the Quebec Class Action, as detailed in note 30. The Group has determined that these payments are recoverable on conclusion of the ongoing appeal and the deposit has not been discounted. While there is uncertainty over the timeframe of the appeal process, it is estimated that had discounting been applied the carrying value of the asset would have been reduced by approximately £4 million.

Amounts receivable from related parties including associated undertakings are shown in note 29.

Trade and other receivables have been reported in the Group Balance Sheet net of allowances as follows:

	2015 £m	2014 £m
Gross trade and other receivables	**3,565**	2,975
Allowance account	**(51)**	(54)
Net trade and other receivables per Balance Sheet	**3,514**	2,921

The movements in the allowance account are as follows:

	2015 £m	2014 £m
1 January	**54**	56
Differences on exchange	**(9)**	(3)
Provided in the year	**8**	11
Amounts reversed during the year	**(2)**	(10)
31 December	**51**	54

Impairment of trade receivables, including write-offs and allowances, charged during the year is included as part of other operating expenses. For 2015, the net impairment charge was £19 million (2014: £4 million) of which £6 million (2014: £1 million) is reflected in the above table.

As at 31 December 2015, trade and other receivables of £75 million (2014: £39 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:

	2015 £m	2014 £m
Less than three months	**64**	31
Between three and six months	**5**	2
Between six months and one year	**4**	3
Greater than one year	**2**	3

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:

	2015 £m	2014 £m
US dollar	**158**	141
UK sterling	**209**	195
Euro	**65**	62
Other currencies	**174**	185

Trade and other receivables also include certain interest bearing amounts and their effective interest rates are as follows:

	2015 £m	2014 £m	2015 %	2014 %
UK sterling	**5**	5	**10.0**	10.0
Euro	**3**	3	**5.2**	4.0
Other currencies	**1**	2	**5.7**	5.5

There is no material difference between the above amounts for trade and other receivables and their fair value due to the short-term duration of the majority of trade and other receivables as determined using discounted cash flow analysis. There is no concentration of credit risk with respect to trade receivables as the Group has a large number of internationally dispersed customers.

15 Available-for-sale investments

	2015 £m	2014 £m
1 January	**86**	90
Differences on exchange	**—**	(4)
Additions and advances	**17**	32
Revaluations	**14**	—
Disposals and repayments	**(45)**	(32)
31 December	**72**	86
Current	**35**	50
Non-current	**37**	36
	72	86

The classification of these investments under the IFRS 13 fair value hierarchy is given in note 24.

Investments have the following maturities:

	As per Balance Sheet	
	2015	**2014**
	£m	**£m**
Equity investments	**37**	36
Non-equity investments		
- within one year	**34**	49
- beyond one year and within two years	**1**	—
- beyond two years and within three years	**—**	1
	72	86

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.

Included within non-equity investments are cash deposits of £17 million (2014: £32 million) which do not meet the definition of cash and cash equivalents.

Investments are all denominated in the functional currency of the subsidiary undertaking holding the investments.

16 Derivative financial instruments

The fair values of derivatives are determined based on market data (primarily yield curves, implied volatilities and exchange rates) to calculate the present value of all estimated flows associated with each derivative at the balance sheet date. In the absence of sufficient market data, fair values would be based on the quoted market price of similar derivatives. The classification of these derivative assets and liabilities under the IFRS 13 fair value hierarchy is given in note 24.

	2015		2014	
	Assets	**Liabilities**	**Assets**	**Liabilities**
	£m	**£m**	**£m**	**£m**
Fair value hedges				
- interest rate swaps	**217**	**23**	300	102
- cross-currency swaps	**40**	**38**	6	18
Cash flow hedges				
- cross-currency swaps	**9**	**—**	30	5
- forward foreign currency contracts	**77**	**70**	139	38
Net investment hedges				
- forward foreign currency contracts	**40**	**75**	55	52
Held-for-trading *				
- interest rate swaps	**52**	**70**	—	—
- cross-currency swaps	**4**	**11**	—	—
- forward foreign currency contracts	**57**	**30**	31	34
Total	**496**	**317**	561	249
Current	**209**	**187**	274	126
Non-current	**287**	**130**	287	123
	496	**317**	561	249
Derivatives				
- in respect of net debt	**373**	**164**	362	137
- other	**123**	**153**	199	112
	496	**317**	561	249

* 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. The Group does not use derivatives for speculative purposes. All derivatives are undertaken for risk management purposes.

For cash flow hedges, the timing of expected cash flows is as follows:

	2015		2014	
	Assets	Liabilities	Assets	Liabilities
	£m	£m	£m	£m
Within one year	**73**	**65**	150	38
Between one and two years	**4**	**5**	17	5
Between two and three years	**—**	**—**	2	—
Beyond five years	**9**	**—**	—	—
	86	**70**	169	43

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.

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:

	2015				2014			
	Assets		Liabilities		Assets		Liabilities	
	Inflow	Outflow	Inflow	Outflow	Inflow	Outflow	Inflow	Outflow
	£m	£m	£m	£m	£m	£m	£m	£m
Within one year								
- forward foreign currency contracts	**5,294**	**(5,133)**	**4,358**	**(4,491)**	4,993	(4,803)	2,960	(2,935)
- cross-currency swaps	**9**	**(21)**	**359**	**(362)**	186	(149)	18	(4)
Between one and two years								
- forward foreign currency contracts	**107**	**(103)**	**323**	**(332)**	398	(377)	112	(115)
- cross-currency swaps	**368**	**(373)**	**361**	**(368)**	19	(16)	343	(370)
Between two and three years								
- forward foreign currency contracts	**—**	**—**	**28**	**(28)**	49	(46)	—	—
- cross-currency swaps	**15**	**(32)**	**16**	**(16)**	19	(20)	—	—
Between three and four years								
- cross-currency swaps	**29**	**(47)**	**30**	**(32)**	19	(22)	—	—
Between four and five years								
- cross-currency swaps	**14**	**(35)**	**16**	**(18)**	34	(23)	—	(14)
Beyond five years								
- cross-currency swaps	**1,465**	**(1,500)**	**458**	**(537)**	709	(774)	—	—
	7,301	**(7,244)**	**5,949**	**(6,184)**	6,426	(6,230)	3,433	(3,438)

The maturity dates of net-settled derivative financial instruments are as follows:

	2015		2014	
	Assets Inflow/ (Outflow)	Liabilities (Inflow)/ Outflow	Assets Inflow/ (Outflow)	Liabilities (Inflow)/ Outflow
	£m	£m	£m	£m
Within one year	**82**	**46**	62	(61)
Between one and two years	**62**	**25**	59	25
Between two and three years	**49**	**11**	49	24
Between three and four years	**37**	**9**	41	10
Between four and five years	**20**	**8**	35	9
Beyond five years	**28**	**19**	55	30
	278	**118**	301	37

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:

	2015 Assets £m	2015 Liabilities £m	2014 Assets £m	2014 Liabilities £m
Interest rate swaps	**269**	**93**	300	102
Cross-currency swaps	**53**	**49**	36	23
Forward foreign currency contracts	**174**	**175**	225	124
	496	**317**	561	249

(a) Interest rate swaps

2015

	Maturity date	Principal currency	m	£m	Interest rate % Original	Interest rate % Swapped	Assets £m	Liabilities £m
Fixed to floating	**2017**	**USD**	**600**	**407**	**2.1**	**note (a)**	**—**	**1**
	2018	**USD**	**750**	**509**	**1.9**	**note (a)**	**1**	**—**
	2019	**GBP**	**250**	**250**	**6.4**	**note (a)**	**38**	**—**
	2020	**EUR**	**600**	**442**	**4.0**	**note (a)**	**59**	**—**
	2020	**GBP**	**650**	**650**	**4.0**	**note (a)**	**23**	**—**
	2020	**USD**	**1,250**	**848**	**2.8**	**note (a)**	**9**	**—**
	2021	**EUR**	**600**	**442**	**3.1**	**note (a)**	**31**	**—**
	2022	**USD**	**900**	**611**	**3.3**	**note (a)**	**7**	**—**
	2023	**EUR**	**750**	**553**	**2.4**	**note (a)**	**52**	**—**
	2025	**EUR**	**650**	**479**	**2.8**	**note (a)**	**49**	**—**
Floating to fixed	**2017**	**EUR**	**600**	**442**	**note (a)**	**3.7**	**—**	**22**
	2023	**EUR**	**750**	**553**	**note (a)**	**2.8**	**—**	**70**
							269	**93**

2014

	Maturity date	Principal currency	m	£m	Interest rate % Original	Interest rate % Swapped	Assets £m	Liabilities £m
Fixed to floating	2017	USD	600	385	2.1	note (a)	—	1
	2019	GBP	250	250	6.4	note (a)	47	—
	2020	EUR	600	466	4.0	note (a)	70	—
	2020	GBP	650	650	4.0	note (a)	27	—
	2021	EUR	600	466	3.1	note (a)	34	—
	2022	USD	900	577	3.3	note (a)	2	—
	2023	EUR	750	582	2.4	note (a)	60	—
	2025	EUR	650	504	2.8	note (a)	60	—
Floating to fixed	2017	EUR	600	466	note (a)	3.7	—	33
	2023	EUR	750	582	note (a)	2.8	—	68
							300	102

Note (a): The floating rate interest rates are based on LIBOR (or local equivalent) plus a margin ranging between 49 and 176 basis points (2014: between 67 and 176 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

2015

	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**	**349**	**—**	**10**
	2019	**EUR**	**4.6**	**20**	**15**	**USD**	**note (b)**	**22**	**15**	**2**	**—**
	2021	**EUR**	**3.6**	**600**	**442**	**GBP**	**note (b)**	**518**	**518**	**—**	**28**
	2021	**CHF**	**0.6**	**320**	**217**	**GBP**	**note (b)**	**210**	**210**	**18**	**—**
	2023	**EUR**	**0.9**	**800**	**590**	**GBP**	**note (b)**	**566**	**566**	**20**	**—**
	2017	**BRL**	**16.7**	**2,008**	**344**	**GBP**	**note (b)**	**354**	**354**	**4**	**—**
Fixed to fixed	**2027**	**EUR**	**12.5**	**800**	**590**	**GBP**	**2.6**	**572**	**572**	**9**	**—**
Floating to fixed	**2017**	**GBP**	**note (b)**	**354**	**354**	**BRL**	**16.7**	**2,008**	**344**	**—**	**11**
										53	**49**

2014

	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	367	—	17
	2019	EUR	4.6	20	16	USD	note (b)	22	14	5	—
	2021	EUR	3.6	600	466	GBP	note (b)	518	518	1	—
	2021	CHF	0.6	320	207	GBP	note (b)	210	210	—	1
Floating to fixed	2015	BRL	note (b)	150	36	USD	1.0	68	44	—	5
	2015	USD	note (b)	261	167	COP	6.8	502,692	136	30	—
										36	23

Note (b): The floating rate interest rates are based on LIBOR (or local equivalent) plus a margin ranging between 64 and 350 basis points (2014: between 65 and 250 basis points).

(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.

	2015		2014	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m
Purchase/Sell				
GBP/EUR	**7**	**12**	32	—
GBP/AUD	**8**	**13**	18	—
GBP/CHF	**5**	**2**	6	—
GBP/USD	**—**	**58**	—	49
GBP/JPY	**8**	**13**	22	—
EUR/GBP	**14**	**1**	—	—
USD/EUR	**18**	**1**	38	—
USD/GBP	**26**	**—**	15	—
USD/JPY	**—**	**—**	43	—
BRL/USD	**—**	**32**	—	35
CHF/GBP	**8**	**—**	—	—
AUD/GBP	**13**	**1**	—	—
NZD/GBP	**6**	**—**	—	—
Other	**61**	**42**	51	40
	174	**175**	225	124

A certain number of these contracts were used to manage the currency profile of external borrowings and are reflected in the currency table in note 21. The nominal values of these contracts are as follows:

	2015		2014	
	Purchase	Sell	Purchase	Sell
	£m	£m	£m	£m
Purchase/Sell				
GBP/CAD	**(181)**	**178**	(204)	202
GBP/USD	**(529)**	**541**	(192)	192
GBP/EUR	**(70)**	**71**	(76)	75
EUR/DKK	**(321)**	**321**	(339)	339
EUR/SEK	**(111)**	**112**	(116)	114
EUR/NOK	**(120)**	**115**	(137)	128
EUR/GBP	**(116)**	**115**	—	—
NOK/EUR	**(115)**	**116**	—	—
CHF/GBP	**(272)**	**264**	(223)	228

17 Inventories

	2015	2014
	£m	£m
Raw materials and consumables	**1,635**	1,732
Finished goods and work in progress	**2,359**	2,211
Goods purchased for resale	**253**	190
	4,247	4,133

Inventories pledged as security for liabilities amount to £8 million (2014: £4 million). Write-offs taken to other operating expenses in the Group Income Statement comprise £73 million (2014: £47 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 2015 and 2014.

19 Cash and cash equivalents

	2015	2014
	£m	£m
Cash and bank balances	**1,325**	1,199
Cash equivalents	**638**	619
	1,963	1,818

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:

	2015	2014
	£m	£m
Functional currency	**1,679**	1,559
US dollar	**167**	115
UK sterling	**8**	13
Euro	**50**	47
Other currency	**59**	84
	1,963	1,818

In the Group Cash Flow Statement, net cash and cash equivalents are shown after deducting bank overdrafts and accrued interest where applicable, as follows:

	2015	2014
	£m	£m
Cash and cash equivalents as above	**1,963**	1,818
Less accrued interest	**(1)**	(1)
Less overdrafts	**(232)**	(325)
Net cash and cash equivalents	**1,730**	1,492

Cash and cash equivalents include restricted amounts of £169 million (2014: £190 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						
	Share capital	Share premium, capital redemption and merger reserves	Other reserve	Retained earnings	Total attributable to owners of the parent	Non-controlling interests	Total equity
	£m	£m	£m	£m	£m	£m	£m
1 January 2015	**507**	**3,923**	**(498)**	**1,578**	**5,510**	**304**	**5,814**
Comprehensive income and expense							
Profit for the year	—	—	—	**4,290**	**4,290**	**232**	**4,522**
Differences on exchange							
- subsidiaries	—	—	**(953)**	—	**(953)**	**(53)**	**(1,006)**
- associates	—	—	**336**	—	**336**	—	**336**
Cash flow hedges							
- net fair value losses	—	—	**(98)**	—	**(98)**	**(1)**	**(99)**
- reclassified and reported in profit for the year	—	—	**14**	—	**14**	**1**	**15**
- reclassified and reported in net assets	—	—	**(45)**	—	**(45)**	—	**(45)**
Available-for-sale investments							
- net fair value gains	—	—	**15**	—	**15**	—	**15**
- reclassified and reported in profit for the year	—	—	**(10)**	—	**(10)**	—	**(10)**
Net investment hedges							
- net fair value losses	—	—	**(118)**	—	**(118)**	—	**(118)**
- differences on exchange on borrowings	—	—	**42**	—	**42**	—	**42**
Tax on items recognised directly in other comprehensive income that may be reclassified subsequently to profit or loss (note 6(f))	—	—	**21**	—	**21**	—	**21**
Retirement benefit schemes							
- net actuarial gains in respect of subsidiaries (note 12)	—	—	—	**283**	**283**	—	**283**
- actuarial gains in respect of associates net of tax (note 5)	—	—	—	**3**	**3**	—	**3**
Tax on items recognised directly in other comprehensive income that will not be reclassified subsequently to profit or loss (note 6(f))	—	—	—	**(23)**	**(23)**	—	**(23)**
Other changes in equity							
Employee share options							
- value of employee services	—	—	—	**50**	**50**	—	**50**
- proceeds from shares issued	—	**4**	—	—	**4**	—	**4**
Dividends and other appropriations							
- ordinary shares	—	—	—	**(2,770)**	**(2,770)**	—	**(2,770)**
- to non-controlling interests	—	—	—	—	—	**(238)**	**(238)**
Purchase of own shares							
- held in employee share ownership trusts	—	—	—	**(46)**	**(46)**	—	**(46)**
Non-controlling interests — acquisitions (note 29)	—	—	—	**(1,642)**	**(1,642)**	**(107)**	**(1,749)**
Other movements	—	—	—	**31**	**31**	—	**31**
31 December 2015	**507**	**3,927**	**(1,294)**	**1,754**	**4,894**	**138**	**5,032**

Notes on the Accounts (Continued)

	Attributable to owners of the parent						
	Share capital	Share premium, capital redemption and merger reserves	Other reserves	Retained earnings	Total attributable to owners of the parent	Non-controlling interests	Total equity
	£m	£m	£m	£m	£m	£m	£m
1 January 2014	507	3,919	(190)	2,398	6,634	301	6,935
Comprehensive income and expense							
Profit for the year	—	—	—	3,115	3,115	278	3,393
Differences on exchange							
- subsidiaries	—	—	(526)	—	(526)	(13)	(539)
- associates	—	—	113	—	113	—	113
Cash flow hedges							
- net fair value gains	—	—	75	—	75	(18)	57
- reclassified and reported in profit for the year	—	—	(76)	—	(76)	9	(67)
- reclassified and reported in net assets	—	—	8	—	8	—	8
Available-for-sale investments of associates							
- net fair value gains	—	—	15	—	15	—	15
Net investment hedges							
- net fair value gains	—	—	2	—	2	—	2
- differences on exchange on borrowings	—	—	60	—	60	—	60
Tax on items recognised directly in other comprehensive income that may be reclassified subsequently to profit or loss (note 6(f))	—	—	21	—	21	3	24
Retirement benefit schemes							
- net actuarial losses in respect of subsidiaries (note 12)	—	—	—	(428)	(428)	—	(428)
- surplus recognition and minimum funding obligations in respect of subsidiaries (note 12)	—	—	—	7	7	—	7
- actuarial losses in respect of associates net of tax (note 5)	—	—	—	(124)	(124)	—	(124)
Tax on items recognised directly in other comprehensive income that will not be reclassified subsequently to profit or loss (note 6(f))	—	—	—	87	87	—	87
Other changes in equity							
Employee share options							
- value of employee services	—	—	—	66	66	—	66
- proceeds from shares issued	—	4	—	1	5	—	5
Dividends and other appropriations							
- ordinary shares	—	—	—	(2,712)	(2,712)	—	(2,712)
- to non-controlling interests	—	—	—	—	—	(260)	(260)
Purchase of own shares							
- held in employee share ownership trusts	—	—	—	(49)	(49)	—	(49)
- share buy-back programme	—	—	—	(800)	(800)	—	(800)
Non-controlling interests — acquisitions (note 29)	—	—	—	(4)	(4)	—	(4)
Non-controlling interests — capital injection (note 26(c))	—	—	—	—	—	4	4
Other movements	—	—	—	21	21	—	21
31 December 2014	507	3,923	(498)	1,578	5,510	304	5,814

Details relating to the allotted share capital, and movements therein, are included in note 4 of the Parent Company financial statements.

(a) Share premium account, capital redemption reserves and merger reserves comprise:

	Share premium account	Capital redemption reserves	Merger reserves	Total
	£m	£m	£m	£m
1 January 2014	70	101	3,748	3,919
31 December 2014	74	101	3,748	3,923
31 December 2015	**78**	**101**	**3,748**	**3,927**

The share premium account includes the difference between the value of shares issued and their nominal value. The increase of £4 million (2014: £4 million) relates solely to ordinary shares issued under the Company's share option schemes. These schemes are described in the Remuneration Report.

On the purchase of own shares as part of the share buy-back programme for shares which are cancelled, a transfer is made from retained earnings to the capital redemption reserve equivalent to the nominal value of shares purchased. Purchased shares which are not cancelled are classified as treasury shares and presented as a deduction from total equity.

Total equity attributable to owners of the parent is stated after deducting the cost of treasury shares which include £4,845 million (2014: £4,845 million) for shares repurchased and not cancelled and £204 million (2014: £228 million) in respect of the cost of own shares held in employee share ownership trusts.

The share buy-back programme was suspended from 30 July 2014 and did not recommence in the current year. During 2014, 23 million shares were bought back at a cost of £795 million excluding transaction costs of £5 million.

In 1999, shares were issued for the acquisition of the Rothmans International B.V. Group, and the difference between the fair value of shares issued and their nominal value was credited to merger reserves.

(b) Information on the principal components of non-controlling interests is provided in note 31.

Notes on the Accounts (Continued)

Movements in other reserves and retained earnings (which are after deducting treasury shares) shown above comprise:

	Translation reserve	Hedging reserve	Available-for-sale reserve	Revaluation reserve	Other	Total other reserves	Retained earnings	
							Treasury shares	Other
	£m	£m	£m	£m	£m	£m	£m	£m
1 January 2015	(1,369)	75	44	179	573	(498)	(5,073)	6,651
Comprehensive income and expense								
Profit for the year	—	—	—	—	—	—	—	4,290
Differences on exchange								
- subsidiaries	(953)	—	—	—	—	(953)	—	—
- associates	336	—	—	—	—	336	—	—
Cash flow hedges								
- net fair value losses	—	(98)	—	—	—	(98)	—	—
- reclassified and reported in profit for the year	—	14	—	—	—	14	—	—
- reclassified and reported in net assets	—	(45)	—	—	—	(45)	—	—
Available-for-sale investments								
- net fair value gains	—	—	15	—	—	15	—	—
- reclassified and reported in profit for the year	—	—	(10)	—	—	(10)	—	—
Net investment hedges								
- net fair value losses	(118)	—	—	—	—	(118)	—	—
- differences on exchange on borrowings	42	—	—	—	—	42	—	—
Tax on items recognised directly in other comprehensive income that may be reclassified subsequently to profit or loss	—	21	—	—	—	21	—	—
Retirement benefit schemes								
- net actuarial gains in respect of subsidiaries (note 12)	—	—	—	—	—	—	—	283
- actuarial gains in respect of associates net of tax (note 5)	—	—	—	—	—	—	—	3
Tax on items recognised directly in other comprehensive income that will not be reclassified subsequently to profit or loss	—	—	—	—	—	—	—	(23)
Other changes in equity								
Employee share options								
- value of employee services	—	—	—	—	—	—	—	50
Dividends and other appropriations								
- ordinary shares	—	—	—	—	—	—	—	(2,770)
Purchase of own shares								
- held in employee share ownership trusts	—	—	—	—	—	—	(46)	—
Non-controlling interests — acquisitions (note 29)	—	—	—	—	—	—	—	(1,642)
Other movements	—	—	—	—	—	—	70	(39)
31 December 2015	(2,062)	(33)	49	179	573	(1,294)	(5,049)	6,803

	Translation reserve	Hedging reserve	Available-for-sale reserve	Revaluation reserve	Other	Total other reserves	Retained earnings	
							Treasury shares	Other
	£m	£m	£m	£m	£m	£m	£m	£m
1 January 2014	(1,015)	44	29	179	573	(190)	(4,325)	6,723
Comprehensive income and expense								
Profit for the year	—	—	—	—	—	—	—	3,115
Differences on exchange								
- subsidiaries	(526)	—	—	—	—	(526)	—	—
- associates	113	—	—	—	—	113	—	—
Cash flow hedges								
- net fair value gains	—	75	—	—	—	75	—	—
- reclassified and reported in profit for the year	—	(76)	—	—	—	(76)	—	—
- reclassified and reported in net assets	—	8	—	—	—	8	—	—
Available-for-sale investments of associates								
- net fair value gains	—	—	15	—	—	15	—	—
Net investment hedges								
- net fair value gains	2	—	—	—	—	2	—	—
- differences on exchange on borrowings	60	—	—	—	—	60	—	—
Tax on items recognised directly in other comprehensive income that may be reclassified subsequently to profit or loss	(3)	24	—	—	—	21	—	—
Retirement benefit schemes								
- net actuarial losses in respect of subsidiaries (note 12)	—	—	—	—	—	—	—	(428)
- surplus recognition and minimum funding obligations in respect of subsidiaries (note 12)	—	—	—	—	—	—	—	7
- actuarial losses in respect of associates net of tax (note 5)	—	—	—	—	—	—	—	(124)
Tax on items recognised directly in other comprehensive income that will not be reclassified subsequently to profit or loss	—	—	—	—	—	—	—	87
Other changes in equity								
Employee share options								
- value of employee services	—	—	—	—	—	—	—	66
- proceeds from shares issued	—	—	—	—	—	—	1	—
Dividends and other appropriations								
- ordinary shares	—	—	—	—	—	—	—	(2,712)
Purchase of own shares								
- held in employee share ownership trusts	—	—	—	—	—	—	(49)	—
- share buy-back programme	—	—	—	—	—	—	(800)	—
Non-controlling interests — acquisitions (note 29)	—	—	—	—	—	—	—	(4)
Other movements	—	—	—	—	—	—	100	(79)
31 December 2014	(1,369)	75	44	179	573	(498)	(5,073)	6,651

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.

Notes on the Accounts (Continued)

Of the amounts released from the hedging reserve during the year, losses of £50 million (2014: £21 million gain) and gains of £22 million (2014: £27 million gain) were reported within revenue and raw materials and consumables respectively, together with a loss of £8 million (2014: £13 million loss) reported in other operating expenses and a gain of £18 million (2014: £31 million gain) reported within net finance costs.

Other reserves comprise:

(a) £483 million which arose in 1998 from merger accounting in a Scheme of Arrangement and Reconstruction whereby British American Tobacco p.l.c. acquired the entire share capital of B.A.T Industries p.l.c. and the share capital of that company's principal financial services subsidiaries 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:

	2015	2014
	£m	£m
Translation reserve		
Net investment hedges		
- difference on exchange on borrowings	—	(3)
	—	(3)
Hedging reserve		
Cash flow hedges		
- net fair value losses/(gains)	**38**	(3)
- reclassified and reported in profit for the year	**(17)**	27
	21	24
Retained earnings		
- actuarial (gains)/losses in respect of subsidiaries	**(23)**	89
- surplus recognition and minimum funding obligations in respect of subsidiaries	—	(2)
	(23)	87
Owners of the parent	**(2)**	108
Non-controlling interests	—	3
Total tax recognised in other comprehensive income for the year (note 6(f))	**(2)**	111

21 Borrowings

	Currency	Maturity dates	Interest rates	2015	2014
				£m	£m
Eurobonds	Euro	2017 to 2045	0.4% to 5.4%	**6,603**	5,211
	Euro	2018	3m EURIBOR + 50bps	**294**	309
	UK sterling	2016 to 2055	4.0% to 7.3%	**3,413**	3,083
	US dollar	2016	1.1%	**203**	192
	Swiss franc	2016	CHF 3m LIBOR + 16bps	**238**	226
	Swiss franc	2021 to 2026	0.7% to 1.4%	**446**	419
Bonds issued pursuant to Rule 144A and RegS under the US Securities Act (as amended)	US dollar	2017 to 2025	1.9% to 9.5%	**4,208**	1,726
	US dollar	2018	USD 3m LIBOR + 51bps	**339**	—
Bonds and notes				**15,744**	11,166
Commercial paper				**505**	160
Other loans				**236**	223
Bank loans				**258**	374
Bank overdrafts				**232**	325
Finance leases				**26**	10
				17,001	12,258

The interest on the commercial paper referred to in the table above is based on USD LIBOR plus a margin ranging between 25 and 43 basis points (2014: 10 and 43 basis points).

	2015	2014
	£m	£m
Current	**2,195**	2,479
Non-current	**14,806**	9,779
	17,001	12,258

Current borrowings include interest payable of £210 million at 31 December 2015 (2014: £240 million). Included within borrowings are £7,394 million (2014: £4,522 million) of borrowings subject to fair value hedges where their amortised cost has been increased by £201 million (2014: £228 million) in the table above.

The fair value of borrowings is estimated to be £20,448 million (2014: £13,606 million). £19,059 million (2014: £12,533 million) has been calculated using quoted market prices and is within level 1 of the fair value hierarchy. £1,389 million (2014: £1,073 million) has been calculated based on discounted cash flow analysis and is within level 2 of the fair value hierarchy.

	2015	2014
	£m	£m
Amounts secured on Group assets	**34**	14

In both years amounts secured on Group assets include finance leases of £26 million (2014: £10 million) and amounts secured on certain inventory of the Group (see note 17).

Borrowings are repayable as follows:

	Per Balance Sheet		Contractual gross maturities	
	2015	2014	2015	2014
	£m	£m	£m	£m
Within one year	**2,195**	2,479	**2,451**	2,656
Between one and two years	**1,337**	877	**1,905**	1,262
Between two and three years	**1,619**	1,349	**2,110**	1,756
Between three and four years	**1,141**	758	**1,519**	1,085
Between four and five years	**1,325**	560	**1,665**	799
Beyond five years	**9,384**	6,235	**11,902**	7,814
	17,001	12,258	**21,552**	15,372

The contractual gross maturities in each year include the borrowings maturing in that year together with forecast interest payments on all borrowings which are outstanding for all or part of that year.

Borrowings are denominated in the functional currency of the subsidiary undertaking or other currencies as shown below:

	Functional currency	US dollar	UK sterling	Euro	Canadian dollar	Other currencies	Total
	£m	£m	£m	£m	£m	£m	£m
31 December 2015							
Total borrowings	**5,858**	**4,872**	**330**	**4,974**	**—**	**967**	**17,001**
Effect of derivative financial instruments							
- cross-currency swaps	**2,215**	**15**	**(325)**	**(1,637)**	**—**	**(217)**	**51**
- forward foreign currency contracts	**(401)**	**541**	**—**	**(481)**	**178**	**161**	**(2)**
	7,672	**5,428**	**5**	**2,856**	**178**	**911**	**17,050**
31 December 2014							
Total borrowings	5,419	2,240	330	3,478	—	791	12,258
Effect of derivative financial instruments							
- cross-currency swaps	1,195	(109)	(325)	(482)	—	(207)	72
- forward foreign currency contracts	(244)	192	—	(517)	202	358	(9)
	6,370	2,323	5	2,479	202	942	12,321

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	Between 1-2 years	Between 2-3 years	Between 3-4 years	Between 4-5 years	Beyond 5 years	Total
	£m	£m	£m	£m	£m	£m	£m
31 December 2015							
Total borrowings	**2,988**	**1,337**	**986**	**1,140**	**1,324**	**9,226**	**17,001**
Effect of derivative financial instruments							
- interest rate swaps	**4,196**	**35**	**(509)**	**(250)**	**(1,940)**	**(1,532)**	**—**
- cross-currency swaps	**1,333**	**—**	**—**	**(15)**	**—**	**(1,267)**	**51**
	8,517	**1,372**	**477**	**875**	**(616)**	**6,427**	**17,052**
31 December 2014							
Total borrowings	2,492	879	1,347	758	559	6,223	12,258
Effect of derivative financial instruments							
- interest rate swaps	2,832	—	81	—	(250)	(2,663)	—
- cross-currency swaps	1,086	(325)	—	—	(16)	(673)	72
	6,410	554	1,428	758	293	2,887	12,330

Details of the derivative financial instruments included in these tables are given in note 16.

Finance lease liabilities per the Group Balance Sheet and on a contractual gross maturity basis are payable as follows:

	2015	2014
	£m	£m
Within one year	**7**	3
Between one and two years	**6**	2
Between two and three years	**5**	2
Between three and four years	**5**	1
Between four and five years	**2**	1
Beyond five years	**1**	1
	26	10

There is no material difference between the repayable principal and the total gross cash flows shown above.

Borrowings facilities — undrawn committed facilities (see note 24) expire as follows:

	2015	2014
	£m	£m
Within one year	**158**	3,165
Between one and two years	**102**	—
Between two and three years	**—**	96
Between four and five years	**3,000**	3,000
	3,260	6,261

The Group defines net debt as follows:

	2015	2014
	£m	£m
Borrowings (note 21)	**17,001**	12,258
Derivatives in respect of net debt:		
- assets (note 16)	**(373)**	(362)
- liabilities (note 16)	**164**	137
Cash and cash equivalents (note 19)	**(1,963)**	(1,818)
Current available-for-sale investments (note 15)	**(35)**	(50)
	14,794	10,165

22 Other provisions for liabilities and charges

	Restructuring of existing businesses	Employee related benefits	Fox River	Other provisions	Total
	£m	£m	£m	£m	£m
1 January 2015	**104**	**40**	**177**	**167**	**488**
Differences on exchange	**(6)**	**(3)**	**—**	**(22)**	**(31)**
Subsidiaries acquired	**30**	**1**	**—**	**1**	**32**
Provided in respect of the year	**15**	**9**	**—**	**167**	**191**
Utilised during the year	**(54)**	**(9)**	**(17)**	**(31)**	**(111)**
31 December 2015	**89**	**38**	**160**	**282**	**569**
Analysed on the Group Balance Sheet as					
- current	**54**	**17**	**22**	**180**	**273**
- non-current	**35**	**21**	**138**	**102**	**296**
	89	**38**	**160**	**282**	**569**
1 January 2014	88	42	267	184	581
Differences on exchange	(4)	(1)	—	(7)	(12)
Provided/(reversed) in respect of the year	56	8	(27)	47	84
Utilised during the year	(36)	(9)	(63)	(57)	(165)
31 December 2014	104	40	177	167	488
Analysed on the Group Balance Sheet as					
- current	49	13	36	112	210
- non-current	55	27	141	55	278
	104	40	177	167	488

The restructuring provisions relate to the restructuring and integration costs incurred and reported as adjusting items in the Group Income Statement. The principal restructuring activities in 2015 and 2014 are as described in note 3(e). While some elements of the non-current provisions of £35 million will unwind over several years, as termination payments are made over extended periods in some countries, it is estimated that approximately 58% will unwind in 2017 and over 93% within five years.

Employee related benefits mainly relate to long-term employee benefits other than post-employment benefits. As the principal components of these provisions are long service awards and 'jubilee' payments due after a certain service period, they will unwind over several years. It is estimated that approximately 13% of the non-current provisions of £21 million will unwind within five years.

A provision of £274 million was made in 2011 for a potential claim under a 1998 settlement agreement entered into by a Group subsidiary in respect of the clean-up of sediment in the Fox River. On 30 September 2014, the Group, NCR, Appvion and Windward Prospects entered into the Funding Agreement. The details of this agreement are explained in note 30. This agreement led to payments of £9 million in 2015 (2014: £56 million). In addition, the Group incurred legal costs of £8 million (2014: £7 million) which were also charged against the provision. In light of the conclusion of the Funding Agreement, the sums that the Group agreed to pay thereunder, as well as the available information in relation to the extent of the clean-up related costs, the Group reviewed the Fox River provision and £27 million was released from the provision in 2014. It is expected that the non-current provision will unwind within five years.

Other provisions comprise balances set up in the ordinary course of general business that cannot be classified within the other categories, such as sales returns, onerous contracts, 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 reversals of £18 million (2014: £18 million) for restructuring of existing businesses, £nil (2014: £nil) for employee benefits and £6 million (2014: £17 million) for other provisions.

23 Trade and other payables

	2015	2014
	£m	£m
Trade payables	**1,056**	764
Duty, excise and other taxes	**3,481**	3,539
Accrued charges and deferred income	**931**	1,033
FII GLO deferred income (note 6(b))	**963**	—
Social security and other taxation	**15**	7
Sundry payables	**520**	309
	6,966	5,652
Current	**5,937**	5,524
Non-current	**1,029**	128
	6,966	5,652

Accrued charges and deferred income include £14 million of deferred income (2014: £67 million) and £10 million (2014: £6 million) in respect of interest payable. In 2014, deferred income related primarily to government grants for property acquired in Brazil. An amount of £70 million has been accrued in respect of the remaining balance due to be paid for the buy-out of non-controlling interests in Souza Cruz S.A. (see note 26(c)). In 2015, FII GLO deferred income of £963 million relates to receipts in respect of the Franked Investment Income Government Litigation Order (see notes 6(b) and 25). Amounts payable to related parties including associated undertakings are shown in note 29.

There is no material difference between the above amounts for trade and other payables and their fair value due to the short-term duration of the majority of trade and other payables, as determined using discounted cash flow analysis.

Trade and other payables are predominantly denominated in the functional currencies of subsidiary undertakings with less than 7% in other currencies (2014: less than 5%).

24 Financial instruments and risk management

Management of financial risks

One of the principal responsibilities of Treasury is to manage the financial risks arising from the Group's underlying operations. Specifically Treasury manages, within an overall policy framework set by the Group's Main Board and Corporate Finance Committee (CFC), the Group's exposure to funding and liquidity, interest rate, foreign exchange and counterparty risks. The Group's treasury position is monitored by the CFC which meets regularly throughout the year and is chaired by the Group Finance Director. The approach is one of risk reduction within an overall framework of delivering total shareholder return.

The Group defines capital as net debt (see note 21) and equity (see note 20). The only externally imposed capital requirement for the Group is interest cover as described under interest rate risk below. The Group assesses its financial capacity by reference to cash flow, net debt and interest cover. Group policies include a set of financing principles and key performance indicators including the monitoring of credit ratings, interest cover and liquidity. These provide a framework within which the Group's capital base is managed and, in particular, the policies on dividends (as a percentage of long-term sustainable earnings) and share buy-back are decided. The key objective of the financing principles is to appropriately balance the interests of equity and debt holders in driving an efficient financing mix for the Group. The Group's average cost of debt is 3.1% in 2015.

The Group manages its financial risks in line with the classification of its financial assets and liabilities in the Group Balance Sheet and related notes.

The Group's management of specific risks is dealt with as follows:

Liquidity risk

It is the policy of the Group to maximise financial flexibility and minimise refinancing risk by issuing debt with a range of maturities, generally matching the projected cash flows of the Group and obtaining this financing from a wide range of providers. The Group has a target average centrally managed debt maturity of at least five years with no more than 20% of centrally managed debt maturing in a single rolling year. As at 31 December 2015, the average centrally managed debt maturity was 7.9 years (2014: 6.8 years) and the highest proportion of centrally managed debt maturing in a single rolling year was 15.0% (2014: 18.7%).

It is Group policy that short-term sources of funds (including drawings under both the Group US$3 billion US commercial paper programme, and the Group £1 billion euro commercial paper (ECP) programme) are backed by undrawn committed lines of credit and cash. Commercial paper is issued by B.A.T. International Finance p.l.c. and guaranteed by British American Tobacco p.l.c. At 31 December 2015, commercial paper of £505 million was outstanding (2014: £160 million).

In February 2015, the Group signed a one-year bridge facility of £2.5 billion with an extension option of up to one year for its public tender offer to acquire up to all of the 24.7% of Souza Cruz shares which were not owned by the Group. The facility was partially cancelled in September, October and November 2015. The facility was cancelled in December 2015.

In March 2015, the Group issued €3 billion of bonds in four tranches as follows: €800 million maturing in 2019, €800 million maturing in 2023, €800 million maturing in 2027 and €600 million maturing in 2045. A €1.25 billion bond was repaid.

In March 2015, a one-year extension option was exercised for the £3 billion main bank facility, extending the final maturity to May 2020. The facility was undrawn as at 31 December 2015 (2014: undrawn). The US$2 billion US commercial paper programme was increased in size to US$3 billion.

In June 2015, the Group issued US$4.5 billion of bonds in five tranches as follows: US$750 million maturing in 2018, US$1,250 million maturing in 2020, US$500 million maturing in 2022, US$1,500 million maturing in 2025 and US$500 million of floating rate notes maturing in 2018. A US$500 million bond was repaid. The US$4.7 billion bridge facility in respect of the RAI transaction was cancelled following the issue of the bonds.

In July 2015, as previously described in note 6(b), the Group received £620 million from HM Revenue & Customs in connection with the Franked Investment Income Group Litigation Order. The Group received a further £343 million in November 2015 from HM Revenue & Customs.

In November 2015, the Group issued a €600 million bond maturing in 2022 and a £350 million bond maturing in 2055.

In March 2014, the Group issued €1 billion of bonds in two tranches as follows: €600 million maturing in 2029 and €400 million of floating rate notes maturing in 2018.

In May 2014, the Group through B.A.T. International Finance p.l.c. negotiated a new main bank facility of £3 billion with a final maturity of May 2019 (with two additional one-year extensions at the option of the banks). This facility is provided by 22 banks. The new facility is on significantly improved terms compared to the previous facility of £2 billion, with a maturity of December 2015, which was cancelled at the same time.

In June 2014, the Group purchased and cancelled an existing US$40 million bond with a maturity of 2029 financed from Group cash balances.

In August 2014, the Group repaid a maturing MYR250 million note, financed from Group cash balances.

In September 2014, the Group issued SFr1 billion of bonds in three tranches as follows: SFr350 million maturing in 2016, SFr400 million maturing in 2021 and SFr250 million maturing in 2026. A one-year bridge facility of US$4.7 billion with an extension option of up to one year for the Group's investment in RAI was signed. A €600 million bond was repaid, financed from Group cash balances.

During the year, the Group's subsidiary in Brazil received proceeds of £255 million (2014: £411 million) from short-term borrowings in respect of advance payments on leaf export contracts and repaid £250 million (2014: £271 million).

The Group has a US$240 million facility, maturing in 2016. This facility is drawable in Chilean peso and was drawn to the value of US$225 million at 31 December 2015 (2014: US$225 million).

The Group utilises cash pooling and zero balancing bank account structures in addition to inter-company loans and borrowings to mobilise cash efficiently within the Group. The key objectives of Treasury in respect of cash and cash equivalents are to protect their principal value, 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 2015 the ratings from Moody's and S&P were A3 (stable outlook)/A- (stable outlook) (2014: A3/A-). The Moody's rating was upgraded from Baa1 to A3 on 12 March 2013. The strength of the ratings has underpinned debt issuance in 2015 and 2014 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 by the issue of bonds in the Swiss franc, euro, US dollar and sterling markets in 2015 and 2014.

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 2015, cash and cash equivalents include £334 million invested in money market funds (2014: £nil).

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 are expected to inhibit the Group's operations or funding plans.

Currency risk

The Group is subject to exposure on the translation of the net assets of foreign currency subsidiaries and associates into its reporting currency, sterling. The Group's primary balance sheet translation exposures are to the US dollar, Canadian dollar, euro, Danish krone, Swiss franc, South African rand, Russian rouble, Brazilian real, Australian dollar, Malaysian ringgit and Singaporean dollar. These exposures are kept under continuous review. The Group's policy on borrowings is to broadly match the currency of these borrowings with the currency of cash flows arising from the Group's underlying operations. Within this overall policy, the Group aims to minimise all balance sheet translation exposure where it is practicable and cost-effective to do so through matching currency assets with currency borrowings. The main objective of these policies is to protect shareholder value by increasing certainty and minimising volatility in earnings per share. At 31 December 2015, the currency profile of the Group's gross debt, after taking into account derivative contracts, was 32% (2014: 19%) US dollar, 30% (2014: 40%) euro, 1% (2014: 2%) Canadian dollar, 30% (2014: 26%) sterling, and 7% (2014: 13%) other currencies.

The Group faces currency exposures arising from the translation of profits earned in foreign currency subsidiaries and associates and joint arrangements; these exposures are not normally hedged. Exposures also arise from:

(i) foreign currency denominated trading transactions undertaken by subsidiaries. These exposures comprise committed and highly probable forecast sales and purchases, which are offset wherever possible. The remaining exposures are hedged within the Treasury policies and procedures with forward foreign exchange contracts and options, which are designated as hedges of the foreign exchange risk of the identified future transactions; and

(ii) forecast dividend flows from subsidiaries to the centre. To ensure cash flow certainty, the Group enters into forward foreign exchange contracts which are designated as net investment hedges of the foreign exchange risk arising from the investments in these subsidiaries.

IFRS 7 *Financial Instruments: Disclosures* requires a sensitivity analysis that shows the impact on the Income Statement and on items recognised directly in other comprehensive income of hypothetical changes of exchange rates in respect of non-functional currency financial assets and liabilities held across the Group. All other variables are held constant although, in practice, market rates rarely change in isolation. Financial assets and liabilities held in the functional currency of the Group's subsidiaries, as well as non-financial assets and liabilities and translation risk, are not included in the analysis. The Group considers a 10% strengthening or weakening of the functional currency against the non-functional currency of its subsidiaries as a reasonably possible change. The impact is calculated with reference to the financial asset or liability held as at the year-end, unless this is unrepresentative of the position during the year.

A 10% strengthening of functional currencies against non-functional currencies would result in pre-tax profit being £3 million lower (2014: £2 million higher) and items recognised directly in other comprehensive income being £326 million higher (2014: £49 million higher). A 10% weakening of functional currencies against non-functional currencies would result in pre-tax profit being £2 million higher (2014: £3 million lower) and items recognised directly in other comprehensive income being £398 million lower (2014: £59 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 2015 it is 11.6 times (2014: 12.0 times). The only externally imposed capital requirement the Group has is in respect of its centrally managed banking facilities, which require a gross interest cover of at least 4.5 times.

In order to manage its interest rate risk, the Group maintains both floating rate and fixed rate debt. The Group sets targets (within overall guidelines) for the desired ratio of floating to fixed rate debt on both a gross and net basis (at least 50% fixed on a net basis in the short to the medium-term) as a result of regular reviews of market conditions and strategy by the CFC and the board of the main central finance company. At 31 December 2015, the relevant ratios of floating to fixed rate borrowings were 44:56 (2014: 45:55) on a gross basis and 33:67 (2014: 30:70) 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 *Financial Instruments: Disclosures* 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 £65 million lower (2014: £35 million lower). A 100 basis point decrease in interest rates, or less where applicable, would result in pre-tax profit being £40 million higher (2014: £20 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 aims to transact with counterparties with strong investment grade credit ratings. However, the Group recognises that due to the need to operate over a large geographic footprint, this will not always be possible. Counterparty credit risk is managed on a global basis by limiting the aggregate amount and duration of exposure to any one counterparty, taking into account its credit rating. The credit ratings of all counterparties are reviewed regularly.

The Group ensures that it has sufficient counterparty credit capacity of requisite quality to undertake all anticipated transactions throughout its geographic footprint, while at the same time ensuring that there is no geographic concentration in the location of counterparties.

With the following exceptions, the maximum exposure to the credit risk of financial assets at the balance sheet date is reflected by the carrying values included in the Group Balance Sheet. The Group has issued guarantees to third parties, part of which has been recognised on the Balance Sheet in accordance with IAS 39 *Financial Instruments: Recognition and Measurement*. The unrecognised portion of these guaranteed amounts was £nil (2014: £28 million). During 2014, the Group entered into a guarantee arrangement in respect of the borrowings of the non-controlling interest in relation to the capital injection made to the Group's Algerian business (see note 26(c)). The maximum exposure under the arrangement would be £3 million (2014: £4 million). In addition, the Group has

entered into short-term risk participation agreements in relation to certain leaf supply arrangements and the maximum exposure under these would be £105 million (2014: £106 million).

The impact of own credit risk on the fair value of derivatives and other obligations held at fair value is not material.

Price risk

The Group is exposed to equity price risk on equity investments held by the Group, which are included in available-for-sale investments on the Group 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 repeated periodically to ensure that the hedge has remained, and is expected to remain highly effective.

Fair value estimation

The fair values of financial assets and liabilities with maturities of less than one year, other than derivatives, are assumed to approximate their book values. For other financial instruments which are measured at fair value in the Balance Sheet, the basis for fair values is described below.

Fair value hierarchy

The following table presents the Group's financial assets and liabilities that are measured at fair value in accordance with the IFRS 13 classification hierarchy:

	2015			
	Level 1	**Level 2**	**Level 3**	**Total**
	£m	**£m**	**£m**	**£m**
Assets at fair value				
Available-for-sale investments (note 15)	**35**	**—**	**37**	**72**
Derivatives relating to				
- interest rate swaps (note 16)	**—**	**269**	**—**	**269**
- cross-currency swaps (note 16)	**—**	**53**	**—**	**53**
- forward foreign currency contracts (note 16)	**—**	**174**	**—**	**174**
Assets at fair value	**35**	**496**	**37**	**568**
Liabilities at fair value				
Derivatives relating to				
- interest rate swaps (note 16)	**—**	**93**	**—**	**93**
- cross-currency swaps (note 16)	**—**	**49**	**—**	**49**
- forward foreign currency contracts (note 16)	**—**	**175**	**—**	**175**
Liabilities at fair value	**—**	**317**	**—**	**317**

	2014			
	Level 1	**Level 2**	**Level 3**	**Total**
	£m	**£m**	**£m**	**£m**
Assets at fair value				
Available-for-sale investments (note 15)	50	—	36	86
Derivatives relating to				
- interest rate swaps (note 16)	—	300	—	300
- cross-currency swaps (note 16)	—	36	—	36
- forward foreign currency contracts (note 16)	—	225	—	225
Assets at fair value	50	561	36	647
Liabilities at fair value				
Derivatives relating to				
- interest rate swaps (note 16)	—	102	—	102
- cross-currency swaps (note 16)	—	23	—	23
- forward foreign currency contracts (note 16)	—	124	—	124
Liabilities at fair value	—	249	—	249

Level 1 financial instruments are traded in an active market and fair value is based on quoted prices at the year-end.

Level 2 financial instruments are not traded in an active market, but the fair values are based on quoted market prices, broker/dealer quotations, or alternative pricing sources with reasonable levels of price transparency. The Group's level 2 financial instruments include OTC derivatives.

The fair values of level 3 financial instruments have been determined using a valuation technique where at least one input (which could have a significant effect on the instrument's valuation) is not based on observable market data. The Group's level 3 financial instruments primarily consist of an equity investment in an unquoted entity which is valued using the discounted cash flows of estimated future dividends. The valuation assumes the following:

- future dividends grow by 3.5% (2014: 2.0%) and a 100 basis points decrease in the growth rate would result in the valuation being £1 million lower (2014: £6 million lower); and
- discount rate of 8.3% (2014: 6.5%) and a 100 basis points decrease in the discount rate would result in the valuation being £14 million higher (2014: £10 million higher).

The following table presents the changes in level 3 financial instruments:

	2015	2014
	Available-for-sale investments	Available-for-sale investments
	£m	£m
1 January	**36**	36
Differences on exchange	**(3)**	—
Revaluation	**14**	—
Disposal	**(10)**	—
31 December	**37**	36

Netting arrangements of derivative financial instruments

The gross fair value of derivative financial instruments as presented in the Group Balance Sheet, together with the Group's rights of offset associated with recognised financial assets and recognised financial liabilities subject to enforceable master netting arrangements and similar agreements, is summarised as follows:

	2015			2014		
	Amount presented in the Group Balance Sheet*	Related amounts not offset in the Group Balance Sheet	Net amount	Amount presented in the Group Balance Sheet*	Related amounts not offset in the Group Balance Sheet	Net amount
	£m	£m	£m	£m	£m	£m
Financial assets						
- Derivative financial instruments (note 16)	**496**	**(272)**	**224**	561	(227)	334
Financial liabilities						
- Derivative financial instruments (note 16)	**(317)**	**272**	**(45)**	(249)	227	(22)
	179	**—**	**179**	312	—	312

* No financial instruments have been offset in the Group Balance Sheet.

The Group is subject to master netting arrangements in force with financial counterparties with whom the Group trades derivatives.

The master netting arrangements determine the proceedings should either party default on their obligations. In case of any event of default: the non-defaulting party will calculate the sum of the replacement cost of outstanding transactions and amounts owed to it by the defaulting party. If that sum exceeds the amounts owed to the defaulting party, the defaulting party will pay the balance to the non-defaulting party. If the sum is less than the amounts owed to the defaulting party, the non-defaulting party will pay the balance to the defaulting party.

25 Cash flow

Cash generated from operations

	2015 £m	2014 £m
Profit from operations	**4,557**	4,546
Adjustments for		
- depreciation, amortisation and impairment costs	**428**	523
- increase in inventories	**(520)**	(405)
- increase in trade and other receivables	**(508)**	(36)
- increase in amounts receivable in respect of the Quebec Class Action	**(55)**	—
- increase in trade and other payables	**732**	203
- FII GLO receipts (note 6(b))	**963**	—
- decrease in net retirement benefit liabilities	**(191)**	(170)
- increase/(decrease) in provisions for liabilities and charges	**48**	(76)
- other non-cash items	**(54)**	49
Cash generated from operations	**5,400**	4,634

Profit from operations includes charges in respect of Group restructuring and integration costs referred to in note 3(e). These are also reflected in the movements in depreciation, amortisation, impairment, inventories, receivables, payables and provisions above and in the proceeds on disposal of property, plant and equipment shown in the Group Cash Flow Statement. The cash outflow in respect of the Group's restructuring costs was £405 million (2014: £325 million).

The cash outflow in respect of the Fox River provision was £17 million (2014: £63 million), as reflected in the movement in provisions in note 22.

Profit from operations includes a charge in respect of Flintkote referred to in note 3(h) and this corresponds with the cash outflow of £3 million (2014: £374 million). The FII GLO cash receipt in 2015 of £963 million is referred to in more detail in note 6(b). The cash outflow in respect of the Quebec Class Action represents the first instalment of the deposit required by the state of Quebec in order for Imperial Tobacco Canada Limited to appeal the class action (see note 30).

Cash flows from investing activities

(a) Property, plant and equipment

In 2015, proceeds on disposal of property, plant and equipment include receipts in respect of Brazil and Australia. The gains related to Australia have been included in restructuring and integration costs (note 3(e)).

In 2014, proceeds on disposal of property, plant and equipment include receipts in respect of Turkey, Uganda and the Democratic Republic of Congo, the gains on which have been included in restructuring and integration costs (note 3(e)).

(b) Purchases of investments

The purchases of investments (which comprise available-for-sale investments and loans and receivables) comprise cash outflows in respect of current investments of £99 million (2014: £31 million outflow).

(c) Proceeds from disposals of investments

The disposals of investments (which comprise available-for-sale investments and loans and receivables) comprise cash inflows in respect of current investments of £45 million (2014: £34 million inflow).

(d) Proceeds from associates' share buy-backs

There were no associate buy-backs in the year (2014: £94 million inflow); as Reynolds American Inc. suspended its buy-back programme due its acquisition of Lorillard, Inc. in 2015.

(e) Purchase of subsidiaries

In October 2015, the Group acquired TDR d.o.o. for cash consideration of £404 million. In December 2015, the Group acquired CHIC, an e-cigarette business based in Poland for £52 million and Blue Nile Cigarette Company Limited, a cigarette business based in the Republic of Sudan for £37 million. See note 26 for further details on the acquisitions in the year.

(f) Investment in associates

In June 2015, in order to maintain its percentage holding of 42%, the Group invested £3,015 million into Reynolds American Inc., an existing associate. The funds were used (among other funds generated by Reynolds American Inc.) to acquire 100% of the equity capital of Lorillard, Inc., which was completed on 12 June 2015.

Cash flows from financing activities

(a) Cash flows from borrowings

In March 2015, the Group issued €3 billion of bonds in four tranches as follows: €800 million maturing in 2019, €800 million maturing in 2023, €800 million maturing in 2027 and €600 million maturing in 2045. A €1.25 billion bond was repaid.

In June 2015, the Group issued US$4.5 billion of bonds in five tranches as follows: US$750 million maturing in 2018, US$1,250 million maturing in 2020, US$500 million maturing in 2022, US$1,500 million maturing in 2025 and US$500 million of floating rate notes maturing in 2018. A US$500 million bond was repaid. The US$4.7 billion bridge facility in respect of the RAI transaction was cancelled following the issue of the bonds.

In November 2015, the Group issued a €600 million bond maturing in 2022 and a £350 million bond maturing in 2055.

In March 2014, the Group issued €1 billion of bonds in two tranches as follows: €600 million maturing in 2029 and €400 million of floating rate notes maturing in 2018.

In June 2014, the Group purchased and cancelled an existing US$40 million bond with a maturity of 2029 financed from Group cash balances. In August 2014, the Group repaid a maturing MYR250 million note, financed from Group cash balances.

In September 2014, the Group issued SFr1 billion of bonds in three tranches as follows: SFr350 million maturing in 2016, SFr400 million maturing in 2021 and SFr250 million maturing in 2026. A €600 million bond was repaid, financed from Group cash balances.

During 2015, the Group's subsidiary in Brazil received proceeds of £255 million (2014: £411 million) from short-term borrowings in respect of advance payments on leaf export contracts and repaid £250 million (2014: £271 million).

(b) Movements relating to derivative financial instruments

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

(c) Purchases of non-controlling interests

In 2015, the purchases of non-controlling interests of £1,677 million related to the acquisition of the non-controlling interest in Souza Cruz S.A. (£1,660 million), part of the non-controlling interest in BAT Chile Operaciones S.A. (£1 million) and part of the non-controlling interests in BAT Central America S.A. (£16 million) (see note 26(c)).

(d) Non-controlling interests – capital injection

There were no capital injections into non-controlling interests in 2015 (2014: £4 million) (see note 26(c)).

26 Business combinations, disposals and other changes in the Group

(a) TDR d.o.o. (TDR)

On 30 May 2015, the Group signed an agreement to acquire TDR and other tobacco and retail assets from Adris Grupa d.d. for a total enterprise value of € 550 million. The transaction was completed on 30 September 2015. The purchase price is subject to the final agreement of adjustments for certain liabilities, and part of the consideration is contingent upon certain targets being met post-acquisition.

TDR is the leading independent cigarette manufacturer in Central Europe with a market leading position in Croatia and a position of scale in Bosnia and Serbia which will provide the Group with the opportunity to significantly grow its business in the region.

By combining its existing business in South East Europe together with TDR, the Group expects to benefit from highly skilled people, well established brands, local high quality operations and strong relationships with distributors and retailers in these markets. As part of the transaction, the Group has committed to keeping TDR's manufacturing facility in Kanfanar, Croatia operational for at least five years following completion of the acquisition.

The provisional goodwill of £116 million on the acquisition of TDR, stated at the exchange rates ruling at the date of the transaction, arises as follows:

Provisional values

	Book value	Fair value adjustments	Fair value
	£m	£m	£m
Intangible assets	2	159	161
Property, plant and equipment	69	26	95
Investments in associates	8	5	13
Deferred tax assets	3	—	3
Inventories	53	8	61
Trade and other receivables	101	—	101
Cash and cash equivalents	4	—	4
Borrowings	(27)	—	(27)
Deferred tax liabilities	—	(32)	(32)
Provisions	(8)	(22)	(30)
Trade and other payables	(50)	—	(50)
Net assets	155	144	299
Less: Non-controlling interests	2	—	2
Net assets acquired			**297**
Goodwill			**116**
Total consideration			**413**

Included in the fair value of consideration above is £9 million of contingent consideration.

Acquisition costs of £2 million have been expensed as part of other operating expenses within restructuring and integration costs (note 3(e)).

The provisional goodwill of £116 million on the acquisition of the business represents a strategic premium to strengthen the Group's position in South East Europe, as well as synergies and cost savings that are anticipated to be realised post-acquisition.

The contribution of this business to the Group's results in 2015 was not material. If the acquisition had occurred on 1 January 2015, the Group's results for the year would not have been materially different.

(b) Other acquisitions

On 22 September 2015, the Group announced the conditional agreement to acquire 100% of the CHIC Group from private shareholders, and the transaction concluded on 30 December 2015. The fair value of the consideration payable was £82 million of which £30 million is contingent on achievement of certain post-acquisition targets. The fair value and book values of net assets acquired were not materially different except for the recognition of trademarks and similar intangibles of £45 million and the recognition of a deferred tax liability of £8 million. Provisional goodwill of £40 million arising on this transaction represents a strategic premium to enter the non-tobacco market. The acquisition of CHIC provides the Group with scale and market reach, with around 800 points of sale in Poland, a number of leading Polish e-cigarette brands, a dedicated e-liquids production facility and a modern research and development centre.

In addition, on 17 November 2015, the Group acquired 100% of Blue Nile Cigarette Company Limited, the number two tobacco manufacturing and distribution company in the Republic of Sudan, from a private shareholder. The fair value of the consideration payable was £45 million of which £8 million is contingent on

achievement of certain post-acquisition targets. The fair value and book values of net assets acquired were not materially different except for the recognition of trademarks and similar intangibles of £34 million. Provisional goodwill of £7 million arising on this transaction represents a strategic premium to enter this market, acquire a manufacturing base in the Republic of Sudan, and benefit from future growth prospects in an emerging market, enhancing the Group's competitive position in the North Africa Area.

The contribution of these businesses to the Group's results in 2015 was not material. If the acquisitions had occurred on 1 January 2015, the Group's results for the year would not have been materially different.

(c) Non-controlling interests

Souza Cruz S.A.

On 16 October 2015, the Group announced that it had concluded the auction related to its public tender offer in Brazil to acquire up to all of the 24.7% of Souza Cruz shares not currently owned by the Group and to delist the company. As a result of the auction, the Group acquired 342,956,819 shares at a price of R$27.20 per share (the Offer Price), representing 22.4% of Souza Cruz. The Group's total ownership of Souza Cruz increased to 97.7% following the auction. Given the level of acceptances at the auction, Souza Cruz cancelled its registration as a publicly listed company. Subsequent to the auction the Group continued to acquire outstanding minority shares at the Offer Price (plus interest) and as at 31 December 2015 the Group owned 99.1% of Souza Cruz. The cost of acquiring these shares up to the end of December 2015 was £1,660 million.

The compulsory acquisition of the remaining minority shares was approved on 5 February 2016, with Souza Cruz becoming a wholly-owned subsidiary as at that date. The cost of acquiring the remaining shares was £70 million.

BAT Chile Operaciones S.A.

During 2015, the Group acquired a further 0.2% interest in BAT Chile Operaciones S.A. at a cost of £1 million. This increased the Group's shareholding to 99%. This transaction is shown as a £1 million reduction to reserves attributable to the owners of the parent in note 20. During 2014, the Group acquired a 1% interest in BAT Chile Operaciones S.A. at a cost of £3 million.

BAT Central America S.A.

During 2015, the Group acquired a further 9% interest in BAT Central America S.A. at a cost of £16 million. This increased the Group's shareholding to approximately 88%. This transaction is shown as a £14 million reduction to reserves attributable to the owners of the parent and a £2 million reduction in reserves attributable to non-controlling interests in note 20. On 15 December 2014, the Group acquired a 1% interest in BAT Central America S.A. at a cost of £1 million.

BAT Algérie S.P.A.

On 8 June 2014, the Group made a capital injection to BAT Algérie S.P.A. at a cost of £4 million. This injection was in proportion to a capital injection made by the non-controlling interest to the Group company and as such, the Group's shareholding remains unchanged.

(d) Other changes in the Group

On 15 December 2014, the Hungarian Government voted in new legislation whereby the distribution of tobacco products to retail would move to a single authorised concession holder. On 11 June 2015 it was announced that a joint venture between Taban Trafik and the Group would be granted a concession for the exclusive distribution of tobacco products, for a period of 20 years. This was effective from 17 November 2015. The Group owns 49% of the issued capital and has an effective economic interest under a profit sharing agreement of 25% in the new entity, which is reported as a joint venture. The investment in the new entity and share of results and net assets at the end of the year is not material to the Group. Transactions between the Group and the entity are classified as related party transactions.

(e) Items classified as held-for-sale

At 31 December 2015, held-for-sale assets comprise land and buildings in Denmark which are being actively marketed for sale.

At 31 December 2014, held-for-sale assets comprised mainly plant and equipment in Souza Cruz and land and buildings in Denmark which were being actively marketed for sale.

27 Share-based payments

The Group operates a number of share-based payment arrangements of which the two principal ones are:

Long-Term Incentive Plan (LTIP)

Nil-cost options exercisable after three years from date of grant with a contractual life of 10 years. Payout is subject to performance conditions based on earnings per share (50% of grant), total shareholder return (25% of grant) and net turnover (25% of grant). Total shareholder return combines the share price and dividend performance of the Company by reference to one comparator group. Participants are not entitled to dividends prior to the exercise of the options. A cash equivalent dividend accrues through the vesting period and is paid on vesting. Both equity and cash-settled LTIPs are granted in March each year.

Deferred Share Bonus Scheme (DSBS)

Free ordinary shares released three years from date of grant and may be subject to forfeit if a participant leaves employment before the end of the three-year holding period. Participants receive a separate payment equivalent to a proportion of the dividend payment during the holding period. Both equity and cash-settled deferred shares are granted in March each year.

The Group also has a number of other arrangements which are not material for the Group and these are as follows:

Sharesave Scheme (SAYE)

Options granted in March each year from 2011 onwards (previously November until 2009 and no options were granted during 2010) by invitation at a 20% discount to the market price. Options to this equity-settled scheme are exercisable at the end of a three-year or five-year savings contract. Participants are not entitled to dividends prior to the exercise of the options. The maximum amount that can be saved by a participant in this way is £6,000 in any tax year.

Share Reward Scheme (SRS) and International Share Reward Scheme (ISRS)

Free shares granted in April each year (maximum £3,000 in any year) under the equity-settled scheme are subject to a three-year holding period. Participants receive dividends during the holding period which are reinvested to buy further shares.

Partnership Share Scheme

Open to all eligible employees, where employees can allocate part of their pre-tax salary to purchase shares in British American Tobacco p.l.c. The maximum amount that can be allocated in this way to any individual is £1,800 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 Group Income Statement in respect of share-based payments were as follows:

	2015		**2014**	
	Equity-settled	**Cash-settled**	**Equity-settled**	**Cash-settled**
	£m	**£m**	**£m**	**£m**
LTIP (note (a))	**1**	**3**	6	1
DSBS (note (b))	**44**	**7**	54	7
SAYE (note (c))	**1**	**—**	1	—
SRS (note (c))	**4**	**—**	5	—
Total recognised in the Income Statement (note 3(a))	**50**	**10**	66	8

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 2015 and 2014:

	2015		2014	
	Vested	Unvested	Vested	Unvested
	£m	£m	£m	£m
LTIP	**1.3**	**3.5**	2.1	3.4
DSBS	**0.1**	**10.4**	0.3	17.4
Total liability	**1.4**	**13.9**	2.4	20.8

(a) Long-Term Incentive Plan

Details of the movements for the equity and cash-settled LTIP scheme during the years ended 31 December 2015 and 31 December 2014, were as follows:

	2015		2014	
	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	**5,198**	**485**	5,592	709
Granted during the period	**2,141**	**160**	2,477	112
Exercised during the period	**(255)**	**(92)**	(1,278)	(281)
Forfeited during the period	**(1,859)**	**(139)**	(1,593)	(55)
Outstanding at end of year	**5,225**	**414**	5,198	485
Exercisable at end of year	**189**	**34**	376	56

The weighted average British American Tobacco p.l.c. share price at the date of exercise for share options exercised during the period was £35.39 (2014: £34.40) for equity-settled and £35.52 (2014: £34.57) for cash-settled options.

The outstanding shares for the year ended 31 December 2015 had a weighted average remaining contractual life of 8.2 years (2014: 8.4 years) for the equity-settled scheme and 7.9 years (2014: 8.0 years) for the cash-settled share-based payment arrangements.

(b) Deferred Share Bonus Scheme

Details of the movements for the equity and cash-settled DSBS scheme during the years ended 31 December 2015 and 31 December 2014, were as follows:

	2015		2014	
	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	**4,262**	**555**	5,105	754
Granted during the period	**1,072**	**172**	1,695	175
Exercised during the period	**(1,874)**	**(260)**	(2,486)	(367)
Forfeited during the period	**(65)**	**(16)**	(52)	(7)
Outstanding at end of year	**3,395**	**451**	4,262	555
Exercisable at end of year	**22**	**1**	18	4

The weighted average British American Tobacco p.l.c. share price at the date of exercise for share options exercised during the financial year was £35.05 (2014: £33.70) for equity-settled and £34.42 (2014: £33.43) for cash-settled options.

The outstanding shares for the year ended 31 December 2015 had a weighted average remaining contractual life of 1.2 years (2014: 1.1 years) for the equity-settled scheme and 1.3 years (2014: 1.0 year) for the cash-settled scheme.

(c) Other schemes

SAYE

The number of outstanding options at the end of the year for the three-year scheme was 345,001 (2014: 352,504) and for the five-year scheme was 495,098 (2014: 558,756).

SRS and ISRS

The number of outstanding shares at the end of the year for the Share Reward Scheme was 412,332 (2014: 456,057) and for the International Share Reward Scheme was 25,332 (2014: 34,748).

Valuation assumptions

Assumptions used in the Black-Scholes models to determine the fair value of share options at grant date were as follows:

	2015		2014	
	LTIP	DSBS	LTIP	DSBS
Expected volatility (%)	**17**	**17**	18	18
Average expected term to exercise (years)	**3.5**	**3.0**	3.5	3.0
Risk-free rate (%)	**0.8**	**0.7**	1.4	1.1
Expected dividend yield (%)	**4.0**	**4.0**	4.2	4.2
Share price at date of grant (£)	**36.25**	**36.25**	32.60	32.60
Fair value at grant date (£)	**14.29**	**32.15**	17.72	19.55

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:

	2015	2014
	%	%
Average share price volatility FMCG comparator group	**19**	20
Average correlation FMCG comparator group	**33**	31

Fair values determined from the Black-Scholes and Monte-Carlo models use assumptions revised at the end of each reporting period for cash-settled share-based payment arrangements.

The expected British American Tobacco p.l.c. share price volatility was determined taking account of the return index (the share price index plus the dividend reinvested) over a five-year period. The FMCG share price volatility and correlation was 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 pay-out 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 87,577 (2014: 90,118).

	2015 Number	2014 Number
Asia-Pacific	**14,671**	17,108
Americas	**15,662**	16,011
Western Europe	**12,645**	12,355
EEMEA	**11,691**	12,488
Subsidiary undertakings	**54,669**	57,962
Associates	**32,908**	32,156
	87,577	90,118

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.

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 with CTBAT International Limited are not included in these disclosures as it is a joint operation.

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 £145 million (2014: £96 million). The Group's share of dividends from associates, included in other net income in the table below, was £640 million (2014: £518 million).

As mentioned in note 26(d), the below table includes amounts related to the new joint venture in 2015 in Hungary.

	2015	2014
	£m	£m
Transactions		
- revenue	**38**	38
- purchases	**(270)**	(279)
- other net income	**639**	512
Amounts receivable at 31 December	**190**	98
Amounts payable at 31 December	**(20)**	(25)

On 17 December 2012, a wholly-owned subsidiary of the Group, BATUS Japan Inc. (BATUSJ), entered into an Amendment and Extension Agreement (referred to as the Amendment) with a wholly-owned subsidiary of Reynolds American Inc. (RAI), R.J. Reynolds Tobacco Company (referred to as RJRT). The Amendment modifies the American blend Cigarette Manufacturing Agreement (referred to as the 2010 Agreement), effective as of 1 January 2010.

Prior to the Amendment, the term of the 2010 Agreement was scheduled to expire on 31 December 2014, subject to early termination and extension provisions. Pursuant to the Amendment, the Manufacturing Agreement will remain in effect beyond 31 December 2014, provided that either RJRT or BATUSJ may terminate the Manufacturing Agreement by furnishing three years' notice to the other party; such notice was given in January 2016.

During 2014, the Group received proceeds of £94 million in respect of its participation in the share buy-back programme conducted by RAI. This programme ceased in the second quarter of 2014.

On 12 June 2015, RAI completed its acquisition of Lorillard, Inc. and related divestiture transactions to ITG Brands LLC, a subsidiary of Imperial Tobacco Group PLC, after receiving the required regulatory approval. At the same time, the intention of which was announced on 15 July 2014, the Group invested US$4.7 billion (£3.0 billion) of cash in RAI to maintain its 42% equity position in the enlarged business.

In addition, on 1 December 2015, the Group and RAI announced an agreement providing a framework for collaboration and mutual cross-licensing of vapour product technologies through 2022.

During 2015, the Group acquired a further 24% interest in Souza Cruz S.A. at a cost of £1,660 million. This increased the Group's shareholding to 99%. This transaction is shown as a £1,555 million reduction to reserves attributable to the owners of the parent and a £105 million reduction in reserves attributable to non-controlling interests in note 20. The compulsory acquisition of the remaining shares was approved on 5 February 2016, with Souza Cruz S.A. becoming a wholly-owned subsidiary at that date. The cost of acquiring the remaining shares was £70 million. During 2015, the Group acquired a further 0.2% interest in BAT Chile Operaciones S.A. at a cost of £1 million. This increased the Group's shareholding to 99%. This transaction is shown as a £1 million reduction to reserves attributable to the owners of the parent in note 20.

During 2015, the Group acquired a further 9% interest in BAT Central America S.A. at a cost of £16 million. This increased the Group's shareholding to 88%. This transaction is shown as a £14 million reduction to reserves attributable to the owners of the parent and a £2 million reduction in reserves attributable to non-controlling interests in note 20.

For comparative purposes, prior year's acquisitions are disclosed in note 26.

As explained in note 12, contributions to the British American Tobacco UK Pension Fund are secured by a charge over the Group's Head Office (Globe House) up to a maximum of £150 million.

The key management personnel of British American Tobacco consist of the members of the Board of Directors of British American Tobacco p.l.c. and the members of the Management Board. No such person had any material interest during the year in a contract of significance (other than a service contract) with the Company or any subsidiary company. The term key management personnel in this context includes the respective members of their households.

	2015	2014
	£m	£m
The total compensation for key management personnel, including Directors, was:		
- salaries and other short-term employee benefits	**20**	20
- post-employment benefits	**4**	3
- share-based payments	**11**	13
	35	36

There were no other long-term benefits applicable in respect of key personnel other than those disclosed in the Remuneration Report.

30 Contingent liabilities and financial commitments

1. The Group is subject to contingencies pursuant to requirements that it complies with relevant laws, regulations and standards.

2. Failure to comply could result in restrictions in operations, damages, fines, increased tax, increased cost of compliance, interest charges, reputational damage or other sanctions. These matters are inherently difficult to quantify. In cases where the Group has an obligation as a result of a past event existing at the balance sheet date, it is probable that an outflow of economic resources will be required to settle the obligation and if the amount of the obligation can be reliably estimated, a provision will be recognised based on best estimates and management judgement.

3. There are, however, contingent liabilities in respect of litigation, taxes in some countries and guarantees for which no provisions have been made.

General litigation

Product liability litigation

4. Group companies, notably Brown & Williamson Holdings, Inc. (formerly Brown & Williamson Tobacco Corporation) (B&W) as well as other leading cigarette manufacturers, are defendants in a number of product liability cases. In a number of these cases, the amounts of compensatory and punitive damages sought are significant.

Indemnity

5. On 30 July 2004, B&W completed the combination of the assets, liabilities and operations of its US tobacco business with R.J. Reynolds Tobacco Company (RJRT), a wholly-owned subsidiary of R.J. Reynolds Tobacco Holdings, Inc., pursuant to which Reynolds American Inc. was formed (the "Business Combination"). As part of the Business Combination, B&W contributed to RJRT all of the assets and liabilities of its US cigarette and tobacco business, subject to specified exceptions, in exchange for a 42%. equity ownership interest in Reynolds American Inc.

6. As a result of the Business Combination, RJRT assumed all liabilities of B&W (except liabilities to the extent relating to businesses and assets not contributed by B&W to RJRT and other limited categories of liabilities) and contributed subsidiaries or otherwise to the extent related to B&W's tobacco business as conducted in the US on or prior to 30 July 2004. In addition, RJRT agreed to indemnify B&W and each of its associates (other than Reynolds American Inc. and its subsidiaries) against, among other matters, all losses (including those arising from Environmental Tobacco Smoke (ETS) claims), liabilities, damages, expenses, judgments, attorneys' fees, etc., to the extent relating to or arising from such assumed liabilities or the assets contributed by B&W to RJRT (the "RJRT Indemnification").

7. 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").

8. 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.

9. Included in the US Litigation section below are all significant cases where B&W and/or a UK company is named as a defendant and all cases where RJRT is named as a defendant as a successor to B&W (the "RJRT Successor Cases"). The RJRT Successor Cases are covered by the RJRT Indemnification.

US litigation

10. The total number of US product liability cases pending at 31 December 2015 involving B&W was approximately 5,237 (compared to approximately 6,057 in 2014). Of these, 2,236 cases are RJRT Successor Cases. For all of the 5,237 cases involving B&W, British American Tobacco Group companies have the protection of the RJRT Indemnification. As at 31 December 2015, British American Tobacco (Investments) Limited (Investments) has been served as a co-defendant in one of those cases (compared to one in 2014). No other UK-based Group company has been served as a co-defendant in any US product liability case pending as at 31 December 2015. 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

11. 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.

12. At 31 December 2015, one US medical reimbursement suit was pending against B&W by an Indian tribe in an Indian tribal court in South Dakota. No other suits are pending against B&W by county or other political subdivisions of the states.

(b) Class actions

13. At 31 December 2015, B&W was named as a defendant in five separate actions attempting to assert claims on behalf of classes of persons allegedly injured or financially impacted through smoking or where classes of tobacco claimants have been certified. If the classes are or remain certified and the possibility of class-based liability is eventually established, it is likely that individual trials will be necessary to resolve any claims by individual plaintiffs. Class action suits have been filed in a number of states against individual cigarette manufacturers and their parent corporations, alleging that the use of the terms 'lights' and 'ultralights' constitutes unfair and deceptive trade practices:

    (a) Black is a 'lights' class action filed in November 2000, which in 2008, the Circuit Court, City of St. Louis, Missouri stayed pending US Supreme Court review in Good v Altria Group, Inc. A status conference is scheduled for 22 February 2016.

    (b) Howard is a 'lights' class action filed in February 2000 in the Circuit Court, Madison County, Illinois, currently stayed pending resolution of Price v Philip Morris, Inc.

    (c) Jones is a case filed in December 1998 in the Circuit Court, Jackson County, Missouri; the action was brought by tobacco product users and purchasers on behalf of all similarly situated Missouri consumers alleging that the plaintiffs' use of the defendants' tobacco products has caused them to become addicted to nicotine, and seek an unspecified amount of compensatory and punitive damages. There has been limited activity in this case.

    (d) Parsons is a case filed in February 1998 in the Circuit Court, Ohio County, West Virginia currently stayed pending final resolution of a motion brought by the plaintiffs, and because three defendants filed bankruptcy petitions.

(e) Young is a case filed in November 1997 in the Circuit Court, Orleans Parish, Louisiana. This 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 manufactured by the defendants, and who allegedly suffered injury as a result of that exposure, seeks an unspecified amount of compensatory and punitive damages, and has been stayed since 2004.

14. In Engle (a case in Florida), a jury awarded a total of US$12.7 million to three class representatives, and in a later stage of the three-phase trial procedure adopted in this case, a jury assessed US$17.6 billion in punitive damages against B&W. On 21 May 2003, the intermediate appellate court reversed the trial court's judgment and remanded the case to the trial court with instructions to de-certify the class; this was upheld on 6 July 2006. Further, the Florida Supreme Court permitted the judgments entered for two of the three Engle class representatives to stand, but dismissed the judgment entered in favour of the third Engle class representative. Finally, the Florida Supreme Court permitted putative Engle class members to file individual lawsuits against the Engle defendants within one year of the Court's decision (subsequently extended to 11 January 2008).

15. Engle progeny cases, as at 31 December 2015:

	Engle progeny cases in which B&W has been served (both state and federal courts in Florida)	Engle progeny cases in which RJRT is named as a successor to B&W
Number of cases	38	2,224
Number of plaintiffs	94	2,902

16. Phase three trials of individual Engle class members, as at 31 December 2015:

	Additional Phase three Engle Trials naming RJRT as successor to B&W proceeding to verdict
Total number of trials	95
Number of trials resulting in plaintiffs' verdicts	55
Total damages awarded in final judgments against RJRT as successor to B&W (approximately)	US$262,199,662
Amount of overall damages comprising 'compensatory damages' (approximately)	US$141,294,246 (of overall US$262,199,662)
Amount of overall damages comprising 'punitive damages' (approximately)	US$120,905,416 (of overall US$262,199,662)
Number of adverse judgments appealed by RJRT	40*
Number of adverse judgments (not yet appealed), in which RJRT still has time to file an appeal	11

* Of the 40 adverse judgments appealed by RJRT, 25 were decided and/or closed, and 15 appeals remain undecided (including three that have petitions for review pending in the Florida Supreme Court). In three of the appeals that were decided, the Florida intermediate appellate court affirmed the liability finding but vacated the damages award and remanded the matter to the trial court. In three of the appeals that were decided, the Florida intermediate appellate courts reversed the final judgment and remanded the matter to the trial court for a new trial on all issues. In another 18 appeals that were decided, the Florida intermediate appellate courts affirmed final judgments in favour of plaintiffs. One appeal was voluntarily dismissed. RJRT has paid damages to plaintiffs in 15 cases that are now closed.

17. In June 2009, the Florida legislature amended its existing bond cap statute by adding a US$200 million bond cap that applies to all phase three Engle progeny cases in the aggregate and establishing individual bond caps for individual cases in amounts that vary depending on the number of judgments in effect at a given time. In May 2011, Florida removed the provision in this legislation that would have permitted this bond cap to expire on 31 December 2012. Plaintiffs in several Engle progeny cases have unsuccessfully challenged the constitutionality of the bond cap. One of these appellate courts has since certified to the Florida Supreme Court the question of whether the bond cap violates the Florida Constitution. The Florida Supreme Court accepted jurisdiction over the issue of the constitutionality of the bond cap on 23 January 2012. On 31 August 2012, the Florida Supreme Court entered an order dismissing this case based on RJRT's mootness argument. Plaintiff subsequently moved for a rehearing. On 12 October 2012, the Florida Supreme Court denied plaintiff's motion. Plaintiff did not file a petition for writ of certiorari to the United States Supreme Court.

(c) Individual cases

	As at the:	Total number of cases		
Cases pending against B&W which were filed by or on behalf of individuals and in which it is contended that diseases or deaths have been caused by cigarette smoking or by exposure to ETS	31 December 2014	3,052		
	31 December 2015	2,995	2,499	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
			394	Cases brought in consolidated proceedings in West Virginia, where the first phase of the trial began on 15 April 2013 and on 15 May 2013 the jury returned a verdict for defendants on all but one of plaintiffs' claims; the verdict is currently on appeal
			38	Engle progeny cases that have been filed directly against B&W (please see earlier table in paragraph 15)
			64	Cases filed by other individuals

In addition to the 2,224 Engle progeny cases which name RJRT as successor to B&W, there are 12 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.

(d) Conduct-based claims

18. In the Daric Smith case, purchasers of cigarettes in the state of Kansas brought a conspiracy/price fixing class action in the Kansas State Court against B&W, Investments and certain other tobacco companies seeking injunctive relief, treble damages, interest and costs. On 26 March 2012, the Court dismissed the plaintiff's first amended petition with prejudice. On appeal, the Court of Appeals of Kansas, on 18 July 2014, affirmed the trial court's order. On 29 June 2015, the Supreme Court of Kansas denied plaintiff's petition for review. The case is now closed and will be removed from future reports.

UK-based Group companies

19. As at 31 December 2015, Investments has been served in one dormant individual action in the US (Perry) in which there has been no activity since 1998 following the plaintiff's death in 1997.

Product liability outside the United States

20. As at 31 December 2015, active product liability claims against the Group's companies existed in 14 markets outside the US (2014: 15) but the only markets with more than five claims were Argentina, Brazil, Canada, Chile, Italy and Nigeria. As at 31 December 2015, medical reimbursement actions are being brought in Argentina, Brazil, Canada, Nigeria and South Korea.

(a) Medical reimbursement cases

Argentina

21. In 2007, the non-governmental organisation the Argentina Tort Law Association (ATLA) and Emma Mendoza Voguet brought a reimbursement action against Nobleza Piccardo S.A.I.C.y F. (Nobleza) and Massalín Particulares. The case is being heard in the Contentious Administrative Court and is currently at the evidentiary stage.

Brazil

22. In August 2007, the São Paulo Public Prosecutor's Office filed a medical reimbursement claim against Souza Cruz S.A. (Souza Cruz). A similar claim was lodged against Philip Morris. On 4 October 2011, the Court dismissed the action against Souza Cruz, with a judgment on the merits. The plaintiff filed an appeal on 9 January 2012 and Souza Cruz filed its counter arguments on 17 February 2012. On 23 April 2013, the Justices of the 2nd Civil Chamber of the Court of Appeals of the State of São Paulo, by unanimous vote (3 to 0), denied the appeal of the Prosecution Office, thereby confirming the favourable Lower Court ruling. The Public Prosecutor's Office has filed a Special Appeal.

Canada

23. In Canada there are 10 active statutory actions for recovery of healthcare costs arising from the treatment of smoking and health-related diseases. These proceedings name various Group companies as defendants, including the Company, Investments, B. A.T Industries p.l.c. (Industries), Carreras Rothmans Limited (collectively the "UK Companies") and Imperial Tobacco Canada Limited (Imperial), the Group's operating company in Canada. Legislation enabling provincial governments to recover the healthcare costs has been enacted in all 10 provinces and two of three territories in Canada and has been proclaimed in force in 10 provinces. The Acts have received Royal Assent in Northwest Territories and Nunavut but have yet to be proclaimed into force. Actions have begun against various Group companies, including Imperial, in British Columbia, New Brunswick, Newfoundland and Labrador, Ontario, Quebec, Manitoba, Alberta, Saskatchewan, Nova Scotia and Prince Edward Island (PEI). In Quebec, three Canadian manufacturers, including Imperial, challenged the enabling legislation. This challenge was dismissed. One other manufacturer is seeking leave to appeal to the Supreme Court of Canada.

24.

Canadian province	Act pursuant to which claim was brought	Companies named as defendants and date served	Current stage
British Columbia	Tobacco Damages and Health Care Costs Recovery Act 2000	Imperial. Investments. Industries. Other former Rothmans Group companies.	The underlying medical reimbursement action remains at a preliminary case management stage. Damages have not been quantified by the province. The federal government has commenced a cost assessment in connection with the motion and appeals relating to the federal government claim, seeking CAD$5 million jointly from all the defendants and an additional CAD$5 million from Imperial. No hearing date has been set.
New Brunswick	Tobacco Damages and Health Care Costs Recovery Act 2006	The UK Companies have all been named as defendants. Imperial and the UK Companies have all been served.	Both Imperial and the UK Companies have now filed their defences and document production by the defendants is substantially complete. A first round of oral discoveries of the province began in September 2014 and a second round will continue at least through the end of Q2 of 2016. Damages have been quantified at CAD$19 billion. No trial date has been set.
Ontario	Tobacco Damages and Health Care Costs Recovery Act 2009	The UK Companies have all been named as defendants. Imperial and the UK Companies have all been served.	Following the Supreme Court of Canada's dismissal of the jurisdiction leave application, the case is under case management. Third-party notices against the federal government have been discontinued. Claims against several native manufacturers were filed but are in abeyance. The province has stated its claim to be worth CAD$50 billion. No trial date has been set.

Canadian province	Act pursuant to which claim was brought	Companies named as defendants and date served	Current stage
Newfoundland and Labrador	Tobacco Health Care Costs Recovery Act 2006	The UK Companies have all been named as defendants. Imperial and the UK Companies have all been served.	Particulars and other preliminary motions were filed on 16 January 2015, and a case management conference took place on 22 January 2015. The hearing on the preliminary motions took place on 4–6 March 2015. On 22 December 2015, the Court ordered some particulars to be provided but did not set a date for compliance. Damages have not been quantified by the province. No trial date has been set.
Saskatchewan	Tobacco Damages and Health Care Costs Recovery Act 2012	The UK Companies have all been named as defendants. Imperial and the UK Companies have all been served.	This case is at an early case management stage. A standstill agreement was negotiated under which defences were filed by 27 February 2015 and the matter will remain in abeyance until document production begins in September 2017. Damages have not been quantified by the province.
Manitoba	Tobacco Damages Health Care Costs Recovery Act 2006	Imperial. Investments. Industries. Other former Rothmans Group companies.	This case is at an early case management stage. A standstill agreement has been negotiated, under which defences were filed and the matter will remain in abeyance until document production begins in January 2017. Damages have not been quantified by the province. No trial date has been set.
Alberta	Crown's Right of Recovery Act 2009	Imperial and the UK Companies have all been named as defendants and served.	This case is at an early case management stage. Following particulars motions in January 2015, the province provided certain particulars in October 2015. Defences are to be filed by March 2016 and replies and document production are to follow. The next case management hearing is set for 12 April 2016. The province has stated its claim to be worth CAD$10 billion. No trial date has been set.
Quebec	Tobacco Related Damages and Health Care Costs Recovery Act 2005	Investments, Industries, and Carreras Rothmans Limited have been named as defendants. Imperial and the UK Companies have been served.	On 25 August 2009, Imperial and the other Canadian manufacturers filed a constitutional challenge to the Quebec Medicaid Legislation. This claim was dismissed and a further appeal (heard on 18 June 2015) was also dismissed. Another manufacturer has sought leave to appeal to the Supreme Court of Canada. This case is at an early case management stage. Defences have been filed. Motions over admissibility of documents and damages discovery have been filed but not heard. The province is seeking CAD$60 billion. No trial date has been set.

Canadian province	Act pursuant to which claim was brought	Companies named as defendants and date served	Current stage
Prince Edward Island	Tobacco Damages and Health Care Costs Recovery Act 2009	Imperial and the UK Companies.	This case is at an early case management stage. A standstill agreement has been negotiated. Defences were filed in February 2015 and the next step will be document production, which will commence in September 2017. Damages have not been quantified by the province. No trial date has been set.
Nova Scotia	Tobacco Health Care Costs Recovery Act 2005	Imperial and the UK Companies.	On 22 January 2015, Imperial and the UK Companies were served with the Nova Scotia Medicaid suit. This case is at an early case management stage. A standstill agreement has been negotiated. Defences were filed in July 2015 and the next step will be document production, which will commence on or before 1 September 2017. Damages have not been quantified by the province. No trial date has been set.

Nigeria

25. As at 31 December 2015, six medical reimbursement actions filed by the federal government and five Nigerian states (Lagos, Kano, Gombe, Oyo, Ogun) were pending in the Nigerian courts. British American Tobacco (Nigeria) Limited (BAT Nigeria), the Company and Investments have been named as defendants in each of the cases. The plaintiffs in the six cases seek a total of approximately £38 billion in damages, including special, anticipatory and punitive damages, restitution and disgorgement of profits, as well as declaratory and injunctive relief.

26. The Company and Investments have made a number of challenges to the jurisdiction of the Nigerian courts. Such challenges are still pending (on appeal) against the federal government and the states of Lagos, Kano, Gombe and Ogun. In the state of Oyo, on 13 November 2015, the Company's jurisdictional challenge was successful in the Court of Appeal and the issuance of the writ of summons was set aside. The underlying cases are stayed or adjourned pending the final outcome of these jurisdictional challenges.

South Korea

27. In April 2014, Korea's National Health Insurance Service (NHIS) filed a healthcare recoupment action against KT&G (the state-owned former monopoly), PM Korea and BAT Korea (including BAT Korea Manufacturing). The lawsuit relates to healthcare costs allegedly incurred by the NHIS treating patients with lung (small cell and squamous cell) and laryngeal cancer between 2003 and 2012. The claim is based on allegations of defective design, failure to warn, fraud/misrepresentation, marketing to youth, use of additives and causing addiction. The NHIS is seeking damages of roughly £32 million from the defendants. Court hearings in the case, which constitute the trial, commenced in September 2014 and remain ongoing.

(b) Class actions

Brazil

28. There are currently two class actions being brought in Brazil. One is also a medical reimbursement claim (São Paulo Public Prosecutor's Office), and is therefore discussed above.

29. In 1995, the Associação de Defesa da Saúde do Fumante (ADESF) class action was filed against Souza Cruz and Philip Morris in the São Paulo Lower Civil Court alleging that the defendants are liable to a class of smokers and former smokers for failing to warn of cigarette addiction. The case was stayed in 2004 pending the defendants' appeal from a decision issued by the Lower Civil Court that held that the defendants had not met their burden of proving that cigarette smoking was not addictive or harmful to health, notwithstanding an earlier interlocutory order that the São Paulo Court of Appeals had issued, which directed the trial court to allow more evidence to be taken before rendering its decision.

30. On 12 November 2008, the São Paulo Court of Appeals overturned the lower court's unfavourable decision of 2004, returning the case to the lower court for production of evidence and a new judgment. Following production of evidence, on 16 May 2011, the lower 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 6 September 2012, the case was assigned to a new temporary Reporting Justice in the 7th Chamber of Private Law of the São Paulo Court of Appeals, pending reference to a permanent Reporting Justice of the case. On 10 October 2013, a Reporting Justice of the case was designated. The São Paulo Court of Appeals ruled in favour of defendants in February 2015. Plaintiff has filed a special appeal to the Superior Court of Justice. On 27 November 2015, Souza Cruz filed its response to the appeal, which remains pending.

Canada

31. There are 10 class actions being brought in Canada against Group companies.

32. Knight is a 'lights' class action in which the plaintiff alleges that the marketing of light and mild cigarettes is deceptive because it conveys a false and misleading message that those cigarettes are less harmful than regular cigarettes. Although the claim arises from health concerns, it does not seek compensation for personal injury. Instead it seeks compensation for amounts spent on 'light and mild' products and a disgorgement of profits from Imperial.

33. The Supreme Court of British Columbia certified a class of all consumers who purchased in British Columbia Imperial cigarettes bearing 'light' or 'mild' descriptors since 1974. Whilst the appellate court confirmed the certification of the class, on appeal it limited any financial liability, if proven, to 1997 onward. Imperial's third-party claim against the federal government was dismissed by the Supreme Court of Canada. The federal government is seeking a parallel cost order in this action as it is in the British Columbia government recoupment case. Knight has otherwise been dormant for several years.

34. On 9 December 2009, Imperial was served with a class action filed by Ontario tobacco farmers and the Ontario Flue-Cured Tobacco Growers' Marketing Board (Growers' claim). The plaintiffs allege that, during a specific timeframe, Imperial and two other domestic defendants improperly paid lower prices for tobacco leaf destined for duty-free products and then were smuggled back into Canada and sold in the domestic market. As a preliminary challenge Imperial, and the other domestic defendants, alleged that the Growers' claim is time barred. By decision dated 30 June 2014, the Court dismissed the preliminary challenge. Imperial and the domestic defendants sought leave to appeal that decision, and leave was granted on 14 January 2015. The appeal is scheduled to be heard in April 2016. If Imperial is ultimately successful, the Growers' claim will be dismissed; if not successful, the action will proceed to a class action certification hearing.

35. There are currently two class actions in Quebec. On 21 February 2005, the Quebec Superior Court granted certification in two class actions against Imperial and two other domestic manufacturers, which have a combined value of CAD$21 billion plus interest and costs. The Court certified two classes, which include residents of Quebec who suffered from lung, throat and laryngeal cancer or emphysema as of November 1998 or developed these diseases thereafter and who smoked a minimum of 15 cigarettes a day for at least five years, and residents who were addicted to nicotine at the time the proceedings were filed and who have since remained addicted. The trial in this matter commenced on 12 March 2012 and was completed in December 2014. Judgment was rendered on 27 May 2015. It awarded moral and punitive damages and interest against Imperial and the Canadian subsidiaries of Philip Morris International and Japan Tobacco International in the amount of CAD$15.6 billion, of which Imperial's share is CAD$10.4 billion. An appeal of the judgment was filed on 26 June 2015. It also awarded provisional execution pending appeal of CAD$1.131 billion, of which Imperial's share was approximately CAD$742 million, which order was subsequently overturned by the Court of Appeal. Following the cancellation of the order for provisional execution, the Plaintiffs filed a motion against Imperial and one other manufacturer seeking security in the amount of CAD$5 billion to guarantee, in whole or in part, the payment of costs of the appeal and the judgment. On 27 October 2015, the Court of Appeal ordered the parties to post security in the amount of CAD$984 million, of which Imperial's share is CAD$758 million to be paid in 7 equal quarterly instalments. The first instalment, of just over CAD$108 million, was paid on 30 December 2015. Imperial filed its Factum on Appeal on 11 December 2015 and the appeal is scheduled for November 2016.

36. In June 2009, four new smoking and health class actions were filed in Nova Scotia, Manitoba, Saskatchewan and Alberta, against Canadian and foreign manufacturers and foreign companies, including the UK

Companies and Imperial. In Saskatchewan, the Company and Carreras Rothmans Limited have been released from the action. No date has been set for the certification motion hearing. There are service issues in relation to the UK Companies in Alberta and Manitoba.

37. In July 2010, two further smoking and health class actions in British Columbia were served on Imperial and the UK Companies. The Bourassa claim is allegedly on behalf of all individuals who have suffered chronic respiratory disease and the McDermid claim proposes a class based on heart disease. Both claims state that they have been brought on behalf of those who have "smoked a minimum of 25,000 cigarettes". The UK Companies objected to jurisdiction. Subsequently, the Company was released from Bourassa and McDermid. Industries and Investments remain as defendants in both actions. No certification motion hearing date has been set. Plaintiffs were due to deliver certification motion materials by 31 January 2015, but have not yet done so. Once the materials are delivered, the motions regarding abuse of process will be dealt with.

38. In June 2012, a new smoking and health class action was filed in Ontario against the domestic manufacturers and foreign companies, including Imperial and the UK Companies. Imperial was served on 20 November 2012, and the UK Companies were served on 30 November 2012. The claim is presently in abeyance.

Italy

39. In or about June 2010, BAT Italia was served with a class action filed in the Civil Court of Rome by the consumer association, Codacons, and three class representatives. Plaintiffs primarily asserted addiction-related claims. The class action lawsuit was rejected at the first instance (Civil Court of Rome) and appellate (Rome Court of Appeal) court levels. In July 2012, Codacons filed an appeal before the Italian Supreme Court. At a hearing on 21 January 2015, the Public Prosecutor's Office agreed that the appeal should be rejected, and the Supreme Court reserved its decision with no firm date for issuing judgment. A hearing of procedural issues took place on 26 January 2016 and a decision on these issues is pending.

Venezuela

40. In April 2008, the Venezuelan Federation of Associations of Users and Consumers (FEVACU) and Wolfang Cardozo Espinel and Giorgio Di Muro Di Nunno, acting as individuals, filed a class action against the Venezuelan government. The class action seeks regulatory controls on tobacco and recovery of medical expenses for future expenses of treating smoking-related illnesses in Venezuela. On 5 December 2012, C.A Cigarrera Bigott Sucs. (Cigarrera Bigott) was admitted as an opposing third-party by the Constitutional Chamber of the Supreme Court of Justice and presented its defences and evidence on 26 February 2013. In February 2015, the Constitutional Chamber also admitted ASUELECTRIC, represented by its president Giorgio Di Muro Di Nunno (who had previously filed as an individual), as a third-party. ASUELECTRIC has petitioned the Constitutional Chamber on a number of occasions, requesting that it set a date for a hearing; however, a hearing date is yet to be scheduled.

(c) Individual personal injury claims

41. As at 31 December 2015, the jurisdictions with the most number of active individual cases against Group companies were, in descending order: Brazil (101), Italy (22), Argentina (19), Chile (11), Canada (5) and Ireland (2). There were a further four jurisdictions with one active case only.

Non-tobacco related litigation

Flintkote

42. The Flintkote Company (Flintkote), a US company formerly engaged in the production and sale of asbestos-containing products, was included in the acquisition of Genstar Corporation by Imasco Limited in 1986 and became a Group subsidiary following the restructuring of Imasco Limited (now Imperial Tobacco Canada Limited (Imperial), the Group's operating company in Canada) in 2000. In 2003, Imperial divested Flintkote and then, in 2004, Flintkote filed for bankruptcy in the United States Bankruptcy Court for the District of Delaware. In 2006, Flintkote, representatives of both the present and future asbestos plaintiffs (collectively, the "Flintkote Plaintiffs"), and certain individual asbestos plaintiffs (the "Hopkins Plaintiffs") were permitted by the Bankruptcy Court to file a complaint in the California State Court against Imperial and numerous other defendants, for the recovery of certain dividends declared by Flintkote in 1986 and 1987, and other compensation under various legal and equitable theories.

43. Following extensive discovery and a series of bench trials over a multi-year period, the Court narrowed the claims that might ultimately go to trial, but Flintkote and the Hopkins Plaintiffs continued to pursue

substantial claims against Imperial. On 17 December 2014, following a series of formal mediation sessions and other negotiations, Imperial and the Flintkote Plaintiffs executed a settlement agreement. In furtherance of this settlement, Imperial placed into escrow the required settlement payment of US$575 million. The settlement was contingent upon further documentation and approval of the United States Bankruptcy Court for the District of Delaware, where Flintkote's bankruptcy case remains pending, and the United States District Court for the District of Delaware. On 10 August 2015 and 13 August 2015, respectively, the Bankruptcy Court and the District Court entered orders approving the settlement and confirming Flintkote's plan of reorganisation, which implements the settlement. The settlement finally and completely resolves the existing Flintkote litigation, including the claims of the Hopkins Plaintiffs, and Imperial and its corporate affiliates obtained protections from any potential future litigation related to Flintkote. The proceedings in the California State Court litigation, and all claims asserted therein, were dismissed on 14 December 2015. The case is now closed and will be removed from future reports.

Reynolds American, Inc./Lorillard, Inc. Shareholder Litigation

44. On 15 July 2014, Reynolds American, Inc. (Reynolds) announced that it had entered into a definitive merger agreement with Lorillard, Inc. (Lorillard), whereby Reynolds would acquire Lorillard in exchange for a combination of cash and Reynolds' stock (the "Lorillard Transaction"). As part of this transaction, the Company executed a Share Purchase Agreement to acquire a sufficient number of Reynolds' shares to maintain its 42% equity stake in Reynolds after the merger.

45. On 8 August 2014, the Company was named as a defendant in an action in state court in North Carolina stemming from the announcement of the Lorillard Transaction. The action was brought on behalf of a putative class of Reynolds' shareholders alleging that the Company is a controlling shareholder of Reynolds and breached its fiduciary duty to the other Reynolds' shareholders.

46. On 8 December 2014, the Company moved to dismiss the Amended Complaint. On 28 August 2015, the court issued an order dismissing all claims against the Company. Among other things, the court found that the plaintiff had not properly alleged that the Company was a controlling shareholder of Reynolds and therefore that the Company did not owe a fiduciary duty to Reynolds' other shareholders. On 3 September 2015, the plaintiff filed a notice of appeal. On 11 January 2016, the plaintiff filed its opening brief. The appeal remains pending, and briefing is scheduled to be complete by February 2016.

Khosravi

47. In January 2014, an individual named Mehdi Khosravi issued a claim in the English High Court against the Company, as well as Al Aqili Trading LLC, Mohammed Saleh Al Aqili and Mohammed Saeed Mohamed Al Aqili (the "Al Aqili Defendants"). After obtaining multiple extensions of time for service, in September 2015, the claimant amended his claim to join B.A.T (U.K. and Export) Limited and B.A.T. Pars Company as defendants and served the claim on the Company and B.A.T (U.K. and Export) Limited (the "BAT UK Defendants"). B.A.T. Pars Company has not been served with the claim and therefore is currently not an active party to the proceedings.

48. The claimant sought damages of up to £1.5 billion for alleged personal injuries and economic loss which, he alleged, were caused by the Al Aqili Defendants acting as agents for BAT and/ or for which BAT was vicariously liable. The BAT UK Defendants applied for the orders granting extensions of time for service to be set aside, as well as for the claim to be struck out or dismissed on summary judgment. These applications were heard by a judge on 8 and 11 December 2015. On 28 January 2016, the judge dismissed the case against the BAT UK Defendants and ordered that the claimant should pay their legal costs. The claimant was not given permission to appeal by the High Court but has until 11 March 2016 to seek such permission from the Court of Appeal.

Fox River

Background to environmental liabilities arising out of contamination of the Fox River

49. In Wisconsin, the authorities have identified potentially responsible parties (PRPs) to fund the clean-up of river sediments in the lower Fox River. The pollution was caused by discharges of Polychlorinated Biphenyls (PCBs) from paper mills and other facilities operating close to the river. Among the PRPs is NCR Corporation (NCR).

50. There has been a substantial amount of litigation in the US regarding the responsibility for the costs of the clean-up operations. This can be summarised as follows:

    (a) As regards the mid and lower portions of the Fox River:

    i. NCR was initially made subject to an injunction filed by the US Government against it and Appvion Inc. (Appvion) in the courts of Wisconsin in 2012.

    ii. A subsequent ruling by the same Court in April 2012 found that Appvion was not a PRP, and the injunction was accordingly granted against NCR alone. NCR sought to appeal this decision, but it was affirmed on 3 August 2012.

    iii. A full trial of the merits of the US Government's application for a permanent injunction took place in December 2012 and the Court entered a permanent injunction against NCR.

    iv. On 1 May 2013, the Wisconsin Court ruled that the pollution in the Fox River is not divisible. In a series of rulings, the Wisconsin Court also held that NCR was not entitled to recover any amounts in contribution from other PRPs and that the other PRPs were entitled to recover Fox River clean-up costs from NCR. Cross-claims by Appvion against other PRPs to recover its own Fox River related expenditures were rejected by the Wisconsin Court on 25 June 2013. As a result of these decisions NCR was found wholly responsible for the clean-up of those portions of the river. NCR and Appvion appealed against these decisions.

    v. On 25 September 2014, the US Court of Appeals for the Seventh Circuit:

    1. vacated the decisions finding NCR wholly liable. The Court remanded the case to the district court for further consideration of defence of divisibility available to NCR. The Court also vacated the permanent injunction against NCR, reasoning that such relief is unnecessary;

    2. remanded the issue of contribution to the district court for reconsideration. The trial is currently set to commence in January 2017; and

    3. found that Appvion is entitled to bring actions against other PRPs to recover its expenses, thereby reversing the trial court's finding in relation to this.

    vi. As a result therefore of the US Court of Appeals for the Seventh Circuit's decision, the district court initially held that harm in Operable Unit 4 of the lower part of the Fox River was divisible and hence that NCR should bear responsibility for a 28% share. However, the district court later reversed that decision on 19 October 2015 and has rejected a further attempt by NCR to reconsider that ruling. On 25 January 2016, the district court denied NCR's motion for an interlocutory appeal of its decision on divisibility. As a consequence, NCR cannot appeal that decision until later in the proceedings. Thus, the present position is that NCR is wholly responsible for the costs of cleaning-up of the mid and lower portions of the river.

    (b) As regards the upper portion of the Fox River:

    i. In July 2012, the Wisconsin Court ruled that NCR was not liable for the clean-up costs in the upper portion of the Fox River. This judgment considered whether NCR was liable as a result of the sale, by a predecessor of NCR's Appleton Papers Division, of scrap paper, or "broke", to other PRPs which, in turn, discharged PCBs into the upper portion of the river in the course of recycling the broke. This order was made final on 27 June 2013.

    ii. On 25 September 2014, the US Court of Appeals for the Seventh Circuit dismissed the other PRPs' appeal against this order.

    iii. As a result, however, of the appellate court decision, the district court reconsidered its previous position and on 3 March 2015 ruled that NCR was liable for the upper portion of the Fox River. That notwithstanding, the district court has since indicated that NCR had no liability for that portion of the river because it did not discharge PCBs there.

51. In NCR's Form 10-K Annual Report for the year ended 31 December 2014, the total clean-up costs for the Fox River are estimated at US$825 million. This estimate is subject to uncertainties and does not include natural resource damages (NRDs). In connection with a settlement entered by certain PRPs, the district court ceded to the Government's request to allow it to withdraw the NRD claims it has prosecuted on behalf of NRD trustees, including those asserted against NCR. NCR retains residual exposure to NRDs in the form of

claims by other PRPs. Previously, NCR had estimated that NRDs may range from US$0 to US$246 million (albeit the US Government in one court filing in 2009 indicated that natural resource damages could be as high as US$382 million).

Industries' involvement with environmental liabilities arising out of the contamination of the Fox River

52. Industries' involvement with the environmental liabilities arises out of indemnity arrangements which it became party to due to a series of transactions that took place from the late-1970s onwards. US authorities have never identified Industries or BATUS as PRPs.

53. In 1978, a subsidiary of Industries, later known as Appleton Papers Inc. and now known as Appvion, purchased what was then NCR's Appleton Papers Division from NCR. Under the terms of the agreement, Industries and Appvion both provided indemnities to NCR concerning certain environmental liabilities. In 1978, Industries also incorporated a US entity by the name of BATUS, Inc. (BATUS), which in 1980 became the holding company for all of Industries' US subsidiaries, including Appvion. As the holding company, BATUS obtained insurance policies for itself and its subsidiaries that included coverage for certain environmental liabilities. Industries/BATUS spun off the Appvion business in 1990 via a Demerger Agreement with Wiggins Teape Appleton p.l.c., now known as Windward Prospects Ltd (Windward), and Wiggins Teape Appleton (Holdings) p.l.c., now known as Arjo Wiggins US Holdings Ltd (collectively, the "AWA Entities"), obtaining what Industries believes were full indemnities from the AWA Entities and Appvion for past and future environmental claims.

54. Disputes between NCR, Appvion, and Industries as to the indemnities given and received under the original purchase agreement in 1978 have been the subject of litigation that was commenced in 1995, a settlement agreement effective from 1998 (the "Settlement Agreement"), and an arbitration award in 2005. NCR took the position that, under the terms of the Settlement Agreement and the arbitration award, Industries and Appvion generally had a joint and several obligation to bear 60% of the Fox River environmental remediation costs imposed on NCR. Until May 2012, Appvion and the AWA Entities paid the 60% share of the clean-up costs and Industries was never required to contribute.

Litigation surrounding Windward's indemnities to Appvion and to Industries

55. The refusal of Appvion and Windward to continue to pay clean-up costs after May 2012 led to NCR making the demands on Industries referenced above. Industries commenced proceedings against Windward and Appvion in the High Court of England & Wales (the "High Court") in December 2011 concerning the indemnity obligations under the 1990 Demerger Agreement and Settlement Agreement. These proceedings were discontinued pursuant to the Funding Agreement, described below.

Funding Agreement of 30 September 2014

56. On 30 September 2014, Industries entered into the Funding Agreement with Windward, Appvion, NCR and BTI 2014 LLC (a wholly-owned subsidiary of Industries). Pursuant to the Funding Agreement, the English Indemnity Proceedings and a counterclaim Appvion had brought in those proceedings, as well as an NCR-Appvion arbitration concerning Appvion's indemnity to NCR, were discontinued as part of an overall agreement between the parties providing a framework through which they would together fund the ongoing costs of the Fox River clean-up. Under the agreement, NCR has agreed to accept funding by BAT at the lower level of 50% of the ongoing clean-up related costs of the Fox River (rather than the 60% referenced above; this remains subject to an ability to litigate the extent to which a further 10% of the costs ought to be allocated at a later stage). In addition Windward and Appvion each committed to contribute to the funding — Windward has contributed US$10 million and Appvion will contribute up to a maximum of US$25 million respectively for each of Fox River and Kalamazoo River (see further below). The parties have also agreed to cooperate in order to maximise recoveries from certain claims that exist against third parties, including those claims which exist against Windward's former shareholder, Sequana S.A. (Sequana), Windward's former directors and Windward's former advisors in relation to dividend payments made by Windward to Sequana totalling over US$800 million in 2008 and 2009. Any proceeds resulting from third-party claims will be applied to meet river clean-up costs first, thereby reducing Industries' obligations under the Funding Agreement and Industries then ranks first in the agreed repayment waterfall should surplus remain. Windward has provided Industries with an agreed direct indemnity to potentially cover shortfalls in recoveries by Industries against the amounts paid out. The Funding Agreement also assigned the claims which Windward has against Sequana, as well as certain claims against former advisers to Windward, to BTI 2014 LLC.

57. Previously, Sequana sought to challenge Windward's ability to enter into the Funding Agreement on the basis of certain restrictions contained in Windward's articles of association. As a consequence, Sequana also challenged the validity of the assignment by Windward to BTI 2014 LLC of certain claims belonging to Windward, including Windward's claim against Sequana and Windward's former directors. Sequana ultimately dropped its challenge on 19 June 2015 meaning BTI 2014 LLC is now free to progress the various assigned claims.

58. Windward commenced a claim against Sequana and the former Windward directors in the High Court of England & Wales (High Court) on 9 May 2014 concerning the dividend payments. Industries filed its own direct claims seeking to recover the dividend payments from Sequana in December 2013. Industries' and Windward's dividend payment claims (the latter were assigned to an Industries subsidiary, BTI 2014 LLC, as part of the Funding Agreement) are set down for trial before the High Court in February 2016.

59. BTI 2014 LLC has brought claims against certain of Windward's former advisors, including Windward's auditors at the time of the dividend payments, PricewaterhouseCoopers LLP.

60. The sums Industries has agreed to pay under the Funding Agreement are subject to ongoing adjustment, as clean-up costs can only be estimated in advance of the work being carried out and as certain sums payable are the subject of ongoing US litigation. In 2014 and 2015, Industries paid £65 million in respect of clean-up costs and is potentially liable for a further £144 million in future clean-up costs. Industries has retained a provision of £160 million which represents the current best estimate of its exposure — see note 22 "Provisions".

Kalamazoo

61. Industries is aware that NCR is also being pursued by Georgia-Pacific, as the owner of a facility on the Kalamazoo River in Michigan which released PCBs into that river. Georgia-Pacific has been designated as a PRP in respect of the river.

62. Georgia-Pacific contends that NCR is responsible for, or should contribute to, the clean-up costs, because:

    (a) a predecessor to NCR's Appleton Papers Division sold "broke" containing PCBs to Georgia-Pacific or others for recycling;

    (b) NCR itself sold paper containing PCBs to Georgia-Pacific or others for recycling; and/or

    (c) 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.

63. A full trial on liability took place in February 2013. On 26 September 2013, the Michigan Court held that NCR was liable as a PRP on the basis that broke sales constituted an arrangement for the disposal of hazardous material for the purposes of CERCLA. The decision was based on NCR's knowledge of the hazards of PCBs from at least 1969, but the Court did not specify directly the entity(ies) whose broke sales form the basis of NCR's liability. NCR will have the ability to appeal the ruling once a final judgment has been entered or it has been otherwise certified for appeal.

64. The second phase of the Kalamazoo trial to determine the apportionment of liability amongst NCR, Georgia-Pacific and the other PRPs (International Paper Company and Weyerhaeuser Company) took place between September and December 2015. Post-briefing submissions will run to 25 March 2016 and a judgment is not expected until some time thereafter. The court may or may not also rule on the allocation of future costs. Industries anticipates that NCR may seek to recover from Appvion (subject to a cap of US$25 million for "Future Sites" under the Funding Agreement as described above) and/or Industries 60% of any Kalamazoo clean-up costs for which it is found liable on the basis, it would be asserted, that the river constitutes a "Future Site" for the purposes of the Settlement Agreement. Industries believes it may have defences to any such claim by NCR. The Funding Agreement described above does not resolve any such claims, but does provide an agreed mechanism pursuant to which any surplus from the valuable recoveries of any third-party claims that remains after all Fox River related clean-up costs have been paid and Industries and NCR have been made whole may be applied towards Kalamazoo clean-up costs, in the event that NCR were to be successful in any claim for a portion of them from Industries or Appvion (subject to Appvion's cap). The quantum of the clean-up costs for the Kalamazoo River is presently unclear (as is the extent of NCR's liability in respect of such costs), but could run into hundreds of millions of dollars. A witness on behalf of Georgia-Pacific testified in the trial concerning the apportionment of liability that the cost of performing

future remediation in Operable Unit 5 of the Kalamazoo River was in the order of US$670 million. Operable Unit 5 is the Kalamazoo River itself, as distinct from the other Operable Units which are landfills or other facilities adjoining the Kalamazoo River. Remediation of these other Operable Units has largely been completed except for monitoring.

65. As detailed above, Industries is taking active steps to protect its interests, including seeking to procure the repayment of the Windward dividends, pursuing the other valuable claims that are now within its control, and working with the other parties to the Funding Agreement to maximise recoveries from third parties with a view to ensuring that amounts funded towards clean-up related costs are later recouped under the agreed repayment mechanisms.

General litigation conclusion

66. 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. An adverse judgment was entered against one Group company, Imperial, in the Quebec class actions and an appeal has been made. If further adverse judgments are entered against any of the Group's companies in any case, appeals will be made. Such appeals could require the appellants to post appeal bonds or substitute security (as has been necessary in Quebec) in amounts which could in some cases equal or exceed the amount of the judgment. In any event, the Group has the benefit of the RJRT Indemnification with regard to US litigation, excluding the litigation brought by the shareholders of Reynolds. 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.

67. Having regard to all these matters, with the exception of Fox River, the Group (i) does not consider it appropriate to make any provision in respect of any pending litigation; and (ii) does not believe that the ultimate outcome of this litigation will significantly impair the Group's financial condition.

Tax disputes

The Group has exposures in respect of the payment or recovery of a number of taxes. The Group is and has been subject to a number of tax audits covering, among others, excise tax, value added taxes, sales taxes, corporate taxes, withholding taxes and payroll taxes.

The estimated costs of known tax obligations have been provided in these accounts in accordance with 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.

The following matters may proceed to litigation:

Brazil

The Brazilian Federal Tax Authority has filed claims against Souza Cruz seeking to reassess the profits of overseas subsidiaries to corporate income tax and social contribution tax. The first reassessment was for the years 2004-2006 in the sum of R$518 million (£89 million) to cover tax, interest and penalties. The second reassessment was for the years 2007 and 2008 in the amount of R$271 million (£46 million) to cover tax, interest and penalties.

Souza Cruz appealed both reassessments. Regarding the first assessment the Souza Cruz appeal was rejected in 2013 although the written judgment of that tribunal is still awaited. The appeal against the second assessment was upheld at the second tier tribunal and was closed. In 2015 a further reassessment for the same period was raised after the five-year statute of limitation. This has been appealed and awaits review at the first tier tribunal.

Souza Cruz received further reassessments in 2014 for the 2009 calendar year in the sum of R$231 million (£40 million), and in 2015 an assessment for the 2010 calendar year in the sum of R$152 million (£26 million) both covering tax, interest and penalties. Souza Cruz appealed both the reassessments in full. Regarding the 2009 assessment the Souza Cruz appeal was rejected and awaits review by the second tier tribunal.

South Africa

In 2011 the South African Revenue Service (SARS) challenged the debt financing of British American Tobacco South Africa (BATSA) and reassessed the years 2006 to 2008. BATSA has objected to and appealed

this reassessment. In 2014, SARS also reassessed the years 2009 and 2010. In 2015, BATSA has filed formal Notices of Appeal against the 2009 and 2010 assessments and has reserved its right to challenge the constitutionality of the assessment at a later date. BATSA have filed a detailed objection letter to the 2009/10 reassessments. Across the period from 2006 to 2010 the reassessments are for R1.79 billion (£78 million) covering both tax and interest.

Netherlands

External bonds of British American Tobacco Holdings (The Netherlands) B.V. are guaranteed by British American Tobacco p.l.c. In 2013, a new Dutch transfer pricing decree was introduced. The authorities are seeking to deny all deductions for guarantee fees going back to 2008, and have issued assessments for the years 2008, 2009 and 2011 in the sum of €31 million (£23 million) to cover tax and interest. The appropriate objection correspondence against these assessments has been filed.

The Group believes that the Group's companies have meritorious defences in law and fact in each of the above matters and intends to pursue each dispute through the judicial system as necessary. The Group does not consider it appropriate to make provision for these amounts assessed nor for any potential further amounts which may be assessed in subsequent years.

While the amounts that may be payable or receivable in relation to tax disputes could be material to the results or cash flows of the Group in the period in which they are recognised, the Board does not expect these amounts to have a material effect on the Group's financial condition.

VAT and duty disputes

Bangladesh

The operating company is in receipt of a retrospective notice of imposition and realisation of VAT and supplementary duty on low price category brands from the National Board of Revenue (NBR) for approximately £162 million. The company is alleged to have evaded tax by selling the products in the low price segments rather than the mid-tier price segments. Management believe that the claims are unfounded.

Litigation has proceeded during 2015. The issue is currently awaiting outcome from the High Court, and a 10% deposit may have to be paid during 2016 in order to pursue any appeal.

Operating leases

Total future minimum lease payments under non-cancellable operating leases comprise leases where payments fall due:

	2015 £m	2014 £m
Property		
Within one year	**51**	52
Between one and five years	**102**	117
Beyond five years	**48**	25
	201	194
Plant and equipment		
Within one year	**19**	24
Between one and five years	**26**	40
	45	64

Performance guarantees

As shown in note 26(a) as part of the acquisition of TDR, the Group has committed to keeping the manufacturing facility in Kanfanar, Croatia operational for at least five years following completion of the acquisition. A similar commitment has been given in respect of the packaging plant in Rovinj, Croatia. The maximum exposure under these guarantees is £38 million.

31 Interests in subsidiaries

Subsidiaries with material non-controlling interests

Non-controlling interests principally arise from the Group's listed investment in Malaysia (British American Tobacco (Malaysia) Berhad) (where the Group held 50% of the listed holding company in both 2015 and 2014).

The Group has assessed that it exercises de facto control over Malaysia as it has the practical ability to direct the business through effective control of the company's board as a result of the Group controlling the largest shareholding block in comparison to other shareholdings which are widely dispersed. Summarised financial information for Malaysia is shown below as required by IFRS 12 *Disclosure of Interests in Other Entities*. As part of the Group's reporting processes, Malaysia report consolidated financial information for the Malaysia group which has been adjusted to comply with Group accounting policies which may differ to local accounting practice. Goodwill in respect of Malaysia, which arose as a result of the acquisition of the Rothmans group referred to in note 9, has not been included as part of the net assets below. No adjustments have been made to the information below for the elimination of inter-company transactions and balances with the rest of the Group.

The Group also held 75% of the listed investment in Brazil (Souza Cruz) in 2014 but acquired substantially all of the non-controlling interests in 2015 (see note 26). Financial information for the Souza Cruz Group is not presented as it no longer has a material non-controlling interest.

	Malaysia Group	
Summarised financial information	**2015**	**2014**
	£m	**£m**
Revenue	**422**	485
Profit for the year	**152**	167
- Attributable to non-controlling interests	***76***	*84*
Total comprehensive income	**136**	167
- Attributable to non-controlling interests	***68***	*83*
Dividends paid to non-controlling interests	**(75)**	(82)
Summary net assets:		
Non-current assets	**43**	55
Current assets	**74**	93
Non-current liabilities	**(8)**	(8)
Current liabilities	**(99)**	(131)
Total equity at the end of the year	**10**	9
- Attributable to non-controlling interests	***5***	*4*
Net cash generated from operating activities	**164**	182
Net cash generated from investing activities	**1**	2
Net cash used in financing activities	**(161)**	(195)
Differences on exchange	**—**	1
Increase/(decrease) in net cash and cash equivalents	**4**	(10)
Net cash and cash equivalents at 1 January	**1**	11
Net cash and cash equivalents at 31 December	**5**	1

Other shareholdings

In the section 'Group Companies and Undertakings' on pages 206 to 212, the Group discloses that it holds 85% (2014: 85%) of the equity shares of PT Bentoel Internasional Investama Tbk (Bentoel). In 2011, the Group sold 984 million shares, representing approximately 14% of Bentoel's share capital, for the purposes of fulfilling certain obligations pursuant to Bapepam LK (Indonesia) takeover regulations. The Group simultaneously entered into a total return swap on 971 million of the shares. As a consequence of this and for the duration of the swap, while the Group does not have legal ownership of these shares, it retains the risks and rewards which results in the Group continuing to recognise an effective interest in 99% of Bentoel's net assets and results.

32 Post balance sheet date announcement

The compulsory acquisition of the remaining minority shares of Souza Cruz S.A. was approved on 5 February 2016, with Souza Cruz S.A. becoming a wholly-owned subsidiary at that date. The cost of acquiring the remaining shares was £70 million.

British American Tobacco, p.l.c.

Independent auditors' report
To the members of British American Tobacco p.l.c.

Report on the Group financial statements

Our opinion

In our opinion, British American Tobacco p.l.c.'s Group financial statements (the 'financial statements'):

- give a true and fair view of the state of the Group's affairs as at 31 December 2014 and of its profit and cash flows for the year then ended;
- have been properly prepared in accordance with International Financial Reporting Standards ('IFRSs') as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006 and Article 4 of the IAS Regulation.

What we have audited

British American Tobacco p.l.c.'s financial statements comprise:

- the Group Balance Sheet as at 31 December 2014;
- the Group Income Statement and Group Statement of Comprehensive Income for the year then ended;
- the Group Cash Flow Statement for the year then ended;
- the Group Statement of Changes in Equity for the year then ended; and
- the Notes on the Accounts, which include a summary of significant accounting policies and other explanatory information.

Certain required disclosures have been presented elsewhere in the Annual Report, rather than in the Notes on the Accounts. These are cross-referenced from the financial statements and are identified as audited.

The financial reporting framework that has been applied in the preparation of the financial statements is applicable law and IFRSs as adopted by the European Union.

Our audit approach

Materiality	• Overall Group materiality is £260 million (2013: £290 million).
Audit Scope	• Out of over 400 reporting units, we identified 51 which, in our view, required an audit of their complete financial information.
	• Specific audit procedures on certain balances and transactions were performed on a further 65 reporting units, one of which represents the results of an associate.
	• Together these accounted for 79% of Group reported profit before taxation.
Areas of Focus	• Corporate tax exposures, including the uncertain tax positions in Brazil and South Africa.
	• Litigation principally in relation to claims and class actions and the recent settlement in respect of Flintkote and the Funding Agreement reached in respect of Fox River.
	• Restructuring and integration costs arising from the Group's continued implementation of its revised operating model.
	• Defined benefit pension plan assets and liabilities.
	• Goodwill impairment assessments.

The scope of our audit and our areas of focus

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) ('ISAs (UK & Ireland)').

We designed our audit by determining materiality and assessing the risks of material misstatement in the financial statements. In particular, we looked at where the Directors made subjective judgements, for example in

respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain. As in all of our audits, we also addressed the risk of management override of internal controls, including evaluating whether there was evidence of bias by the Directors that represented a risk of material misstatement due to fraud.

The risks of material misstatement that had the greatest effect on our audit, including the allocation of our resources and effort, are identified as 'areas of focus' in the following table. We have also set out how we tailored our audit to address these specific areas in order to provide an opinion on the financial statements as a whole. Each of the areas of focus below is referred to in the Audit and accountability section of the Directors' Report on page 58 and in the Accounting Policies on pages 127 to 132. This is not a complete list of all risks identified by our audit.

Area of focus	How our audit addressed the area of focus
Corporate Tax Exposures	
Refer also to notes 6 and 30. The Group operates in many different markets and is therefore subject to varying tax regimes across the world. Where the amount of tax payable or recoverable is uncertain, management is required to apply judgement when determining whether, and how much, to provide in respect of material tax assessments leading to uncertain tax positions in a number of jurisdictions. These principally relate to Brazil, in respect of a reassessment of the profits of overseas subsidiaries to corporate income tax and social contribution tax and South Africa relating to the treatment of debt financing arrangements. We focused on this area due to the significant quantum of gross risk and exposure across the Group, and the inherent complexity and judgement in estimating the amount of provision required.	We held a programme of meetings with the Group's Corporate tax team and local management to assess the Group's process for identifying uncertain tax positions potentially requiring provisions, and the related accounting policy of provisioning for tax exposures. We gained an understanding of the current status of tax investigations and litigation, and monitored changes in circumstance in ongoing disputes through examining recent rulings and correspondence with local tax authorities. We used our specialist tax knowledge and obtained written responses from the Group's external advisers, containing their views on material tax exposures and any related litigation. These procedures assisted in our corroboration of management's position in respect of significant tax exposures, and with our assessment that the disclosures and provisions recorded in the financial statements, including whether any provisions sufficiently addressed probable penalties and interest, were appropriate and reflected the latest developments.
Litigation	
Refer also to notes 22 and 30. There are claims and class actions which could have a significant impact on the results of the Group if the potential exposures were to materialise. Management applies significant judgement when determining whether, and how much, to provide for matters of litigation. We focused on this area due to the number and magnitude of potential exposures across the Group, and the inherent complexity and judgement in whether to provide for or disclose certain exposures. Specific consideration was given to the Fox River and Flintkote matters in light of the Fox River Funding Agreement and Flintkote settlement.	We understood, evaluated and tested management's controls in respect of litigation, both tobacco and non-tobacco related, at the Group, regional and local levels. We discussed the nature and status of exposures with in-house and external legal counsel and obtained letters from the Group's external legal counsel which corroborated management's position for significant litigation matters. We also read publicly available information containing recent updates in respect of court hearings and judgements impacting the Group which also corroborated management's position. We assessed the appropriateness of provisions recorded in the financial statements, or the rationale for not recording a provision, and the completeness of disclosures in respect of contingent liabilities in light of the procedures above.

Area of focus	How our audit addressed the area of focus
	Specifically for the Flintkote and Fox River matters, we corroborated management's position with the terms of the Flintkote Settlement Agreement and the Fox River Funding Agreement. We checked that the classification of the related charges and releases was consistent with the Group's accounting policy on adjusting items.
Restructuring and Integration Costs	
Refer also to note 3. During the year the Group has continued with the implementation of its revised Operating Model and single IT operating system in a number of markets. Accounting judgement is required regarding whether costs incurred meet the criteria to be capitalised as part of the global SAP system within intangible assets, or whether they should be expensed immediately. In addition, judgement is also required when determining whether costs are directly attributable to the programme, and hence presented within adjusting items.	We challenged the appropriateness of the Group's policies in respect of project costs, including the nature of costs to be capitalised, and the timing of commencing depreciation. We did this by confirming that the project costs eligible for capitalisation set out within the policies were directly attributable to the development of the software assets, including the global single instance of SAP, associated with the Group's new operating model. We tested a sample of costs incurred during the period in order to test the appropriateness of £115 million costs capitalised versus £176 million that were expensed. We also assessed the appropriateness of the classification of the related costs as adjusting items and checked that they were consistent with the Group's accounting policy set out on page 131.
Defined benefit pension plan assets and liabilities	
Refer also to note 12. The Group has defined benefit pension plans with net post-retirement liabilities of £741 million and net post-retirement assets of £40 million, which are significant in the context of the overall Balance Sheet of the Group. The valuation of the pension liabilities requires judgement and technical expertise in choosing appropriate assumptions. Changes in a number of the key assumptions (including salary increases, inflation, discount rates and mortality) can have a material impact on the calculation of the liability. The Group uses external actuaries to assist in assessing these assumptions. There is also some judgement in the measurement of fair value of certain pension assets.	We used our specialist actuarial knowledge to obtain evidence that the assumptions used in calculating the pension plan liabilities, including salary increases and mortality rate assumptions, were consistent with relevant national and industry benchmarks. We also verified that the discount and inflation rates used in the valuation of the pension liabilities were consistent with our internally developed benchmarks, and, where available to us, with other companies' reporting as at 31 December 2014. For pension plan assets, we obtained third-party confirmations of ownership and valuations of pension assets.
Goodwill and intangible asset impairment assessments	
Refer also to note 9. The goodwill balance of £9.8 billion, which principally relates to the acquisitions of Rothmans, Imperial Tobacco Canada, ETI (Italy), ST (Scandinavia) and Indonesia, is supported by an annual impairment review. No impairment charge has been recorded by management against these balances in the current financial year. The risk is that the goodwill balance may be overstated and that an impairment charge may be required. The value-in-use assessment for these assets involves subjective judgements about future business performance.	We evaluated the future cash flow forecasts and the process by which they were drawn up, including confirming the accuracy and the underlying calculations and checking the forecasts were consistent with the latest Board approved budgets. We obtained corroborating evidence regarding the carrying value of goodwill, and the related disclosures, through challenging: • the key business drivers of the cash flow forecasts supporting their impairment assessment, including tobacco pricing, raw

Area of focus	How our audit addressed the area of focus
Certain assumptions made by management in the impairment review are key judgements, including cash flows, the overall long-term growth rates and discount rates used. As described in note 9, management concluded that even if discounted cash flows for Cash Generating Units ('CGUs') should fall by 10%, or the discount rate was increased at a post-tax rate of 1%, there would be no impairment to goodwill.	material costs and market share by examining reported results for each CGU and third-party data; • key assumptions for long-term growth rates in the forecasts by comparing them to historical results, and economic forecasts; and • the discount rates by assessing the cost of capital for the Group and country risk adjustments. We examined the results of management's sensitivity analysis around the long-term growth rates and discount rates to ascertain the extent of change in those assumptions that would be required for the goodwill in individual CGUs to be impaired.

How we tailored the audit scope

We tailored the scope of our audit to ensure that we performed enough work to be able to give an opinion on the financial statements as a whole, taking into account the geographic structure of the Group, the accounting processes and controls, and the industry in which the Group operates.

The Group is primarily structured across four geographic regions, being Asia-Pacific; Americas; Western Europe; and Eastern Europe, Middle East and Africa. The Group financial statements are a consolidation of over 400 reporting units, comprising the Group's operating businesses and sales offices (often legal entities), centralised functions, and supply chain entities.

In establishing the overall approach to the Group audit, we determined the type of work that needed to be performed at the reporting units by us, as the Group engagement team, component auditors from PwC network firms and component auditors from other firms operating under our instruction. Where the work was performed by component auditors, we determined the level of involvement we needed to have in the audit work at those reporting units to be able to conclude whether sufficient appropriate audit evidence had been obtained as a basis for our opinion on the Group financial statements as a whole.

The Group's operating reporting units vary significantly in size and we identified 51 which, in our view, required an audit of their complete financial information, due to their size or risk characteristics. Audits of these reporting units were performed using materiality levels lower than the materiality level for the Group as a whole, ranging from £15 million to £60 million, and established by reference to the size of, and risks associated with, the business concerned. Specific audit procedures on certain balances and transactions were performed at a further 65 reporting units, one of which represents the results of an associate. Together these accounted for 79% of Group reported profit before taxation. We performed work centrally in the areas of IT general controls, taxation, pensions, earnings per share and treasury-related procedures.

Our Group engagement team's involvement included various site visits and component auditor working paper reviews across each of the Group's four regions, together with conference calls with the component audit teams and attendance at certain component audit clearance meetings.

Materiality

The scope of our audit was influenced by our application of materiality. We set certain quantitative thresholds for materiality. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures and to evaluate the effect of misstatements, both individually and on the financial statements as a whole.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

Overall Group materiality	£260 million (2013: £290 million).
How we determined it	We used Group reported profit before taxation (£4,848 million) and allowed for the one-off impact of the Flintkote settlement (£374 million). Overall materiality represents approximately 5% of Group reported profit before taxation.
Rationale for benchmark applied	We have allowed for the Flintkote charge as it is non-recurring and represents the settlement of a historical item that does not impact continuing business performance.
Misstatements to be reported to the Audit Committee	We agreed with the Audit Committee that we would report to them misstatements identified during our audit above £15 million (2013: £15 million) as well as misstatements below that amount that, in our view, warranted reporting for qualitative reasons.

Going concern

Under the Listing Rules we are required to review the Directors' statement, set out on page 44, in relation to going concern. We have nothing to report having performed our review.

As noted in the Directors' statement, the Directors have concluded that it is appropriate to prepare the financial statements using the going concern basis of accounting. The going concern basis presumes that the Group has adequate resources to remain in operation, and that the Directors intend it to do so, for at least one year from the date the financial statements were signed. As part of our audit we have concluded that the Directors' use of the going concern basis is appropriate.

However, because not all future events or conditions can be predicted, these statements are not a guarantee as to the Group's ability to continue as a going concern.

Other required reporting

Consistency of other information

Companies Act 2006 opinion

In our opinion the information given in the Strategic Report and the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

ISAs (UK & Ireland) reporting

Under ISAs (UK & Ireland) we are required to report to you if, in our opinion:

• information in the Annual Report is: • materially inconsistent with the information in the audited financial statements; or • apparently materially incorrect based on, or materially inconsistent with, our knowledge of the Group acquired in the course of performing our audit; or • otherwise misleading; or	We have no exceptions to report arising from this responsibility.
• the statement given by the Directors on page 115, in accordance with provision C.1.1 of the UK Corporate Governance Code ('the Code'), that they consider the Annual Report taken as a whole to be fair, balanced and understandable and provides the information necessary for members to assess the Group's performance, business model and strategy is materially inconsistent with our knowledge of the Group acquired in the course of performing our audit; or	We have no exceptions to report arising from this responsibility.
• the section of the Annual Report on page 58, as required by provision C.3.8 of the Code, describing the work of the Audit Committee does not appropriately address matters communicated by us to the Audit Committee.	We have no exceptions to report arising from this responsibility.

Adequacy of information and explanations received

Under the Companies Act 2006 we are required to report to you if, in our opinion, we have not received all the information and explanations we require for our audit. We have no exceptions to report arising from this responsibility.

Directors' remuneration

Under the Companies Act 2006 we are required to report to you if, in our opinion, certain disclosures of Directors' remuneration specified by law are not made. We have no exceptions to report arising from this responsibility.

Corporate governance statement

Under the Listing Rules we are required to review the part of the Corporate Governance Statement relating to the parent company's compliance with 10 provisions of the UK Corporate Governance Code. We have nothing to report having performed our review.

Responsibilities for the financial statements and the audit

Our responsibilities and those of the Directors

As explained more fully in the Responsibility of Directors set out on page 115, the directors are responsible for the preparation of the 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 financial statements in accordance with applicable law and ISAs (UK & Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report, including the opinions, has been prepared for and only for the Company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

What an audit of financial statements involves

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.

We primarily focus our work in these areas by assessing the Directors' judgements against available evidence, forming our own judgements, and evaluating the disclosures in the financial statements.

We test and examine information, using sampling and other auditing techniques, to the extent we consider necessary to provide a reasonable basis for us to draw conclusions. We obtain audit evidence through testing the effectiveness of controls, substantive procedures or a combination of both.

In addition, we read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

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 2014 and on the information in the Directors' Remuneration Report that is described as having been audited.

Paul Cragg (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London

25 February 2015

British American Tobacco, p.l.c.

Group Income Statement
For the year ended 31 December

	Notes	2014	2013
		£m	£m
Gross turnover (including duty, excise and other taxes of £28,535 million (2013: £30,925 million))		**42,506**	46,185
Revenue	2	**13,971**	15,260
Raw materials and consumables used		**(3,088)**	(3,348)
Changes in inventories of finished goods and work in progress		**58**	105
Employee benefit costs	3(a)	**(2,194)**	(2,384)
Depreciation, amortisation and impairment costs	3(b)	**(523)**	(477)
Other operating income	3(c)	**178**	302
Other operating expenses	3(d)	**(3,856)**	(3,932)
Profit from operations	2	**4,546**	5,526
Analysed as:			
- adjusted profit from operations	2	**5,403**	5,820
- restructuring and integration costs	3(e)	**(452)**	(246)
- amortisation of trademarks and similar intangibles	3(f)	**(58)**	(74)
- gain on deemed partial disposal of a trademark	3(g)	**—**	26
- Fox River	3(h)	**27**	—
- Flintkote	3(i)	**(374)**	—
		4,546	5,526
Net finance costs	4	**(417)**	(466)
Finance income		**67**	66
Finance costs		**(484)**	(532)
Share of post-tax results of associates and joint ventures	5	**719**	739
Analysed as:			
- adjusted share of post-tax results of associates and joint ventures	2	**712**	723
- issue of shares and change in shareholding	5	**14**	22
- restructuring and integration costs	5	**4**	(4)
- MSA receipts	5	**5**	33
- other	5	**(16)**	(35)
		719	739
Profit before taxation		**4,848**	5,799
Taxation on ordinary activities	6	**(1,455)**	(1,600)
Profit for the year		**3,393**	4,199
Attributable to:			
Owners of the parent		**3,115**	3,904
Non-controlling interests		**278**	295
		3,393	4,199
Earnings per share			
Basic	7	**167.1p**	205.4p
Diluted	7	**166.6p**	204.6p

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.

British American Tobacco, p.l.c.

Group Statement of Comprehensive Income
For the year ended 31 December

	Notes	2014 £m	2013 £m
Profit for the year (page 121)		**3,393**	4,199
Other comprehensive income			
Items that may be reclassified subsequently to profit or loss:		**(327)**	(1,025)
Differences on exchange			
- subsidiaries		**(539)**	(972)
- associates		**113**	(141)
Cash flow hedges			
- net fair value gains		**57**	94
- reclassified and reported in profit for the year		**(67)**	(49)
- reclassified and reported in net assets		**8**	(1)
Available-for-sale investments of associates			
- net fair value gains/(losses)		**15**	(7)
Net investment hedges			
- net fair value gains		**2**	89
- differences on exchange on borrowings		**60**	(25)
Tax on items that may be reclassified	6(e)	**24**	(13)
Items that will not be reclassified subsequently to profit or loss:		**(458)**	355
Retirement benefit schemes			
- net actuarial (losses)/gains in respect of subsidiaries	12	**(428)**	308
- surplus recognition and minimum funding obligations in respect of subsidiaries	12	**7**	(5)
- actuarial (losses)/gains in respect of associates net of tax	5	**(124)**	90
Tax on items that will not be reclassified	6(e)	**87**	(38)
Total other comprehensive income for the year, net of tax		**(785)**	(670)
Total comprehensive income for the year, net of tax		**2,608**	3,529
Attributable to:			
Owners of the parent		**2,349**	3,272
Non-controlling interests		**259**	257
		2,608	3,529

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						
	Notes	Share capital	Share premium, capital redemption and merger reserves	Other reserves	Retained earnings	Total attributable to owners of parent	Non-controlling interests	Total equity
		£m	£m	£m	£m	£m	£m	£m
Balance at 1 January 2014		**507**	**3,919**	**(190)**	**2,398**	**6,634**	**301**	**6,935**
Total comprehensive income for the year (page 122)		**—**	**—**	**(308)**	**2,657**	**2,349**	**259**	**2,608**
Profit for the year		**—**	**—**	**—**	**3,115**	**3,115**	**278**	**3,393**
Other comprehensive income for the year		**—**	**—**	**(308)**	**(458)**	**(766)**	**(19)**	**(785)**
Employee share options								
- value of employee services		**—**	**—**	**—**	**66**	**66**	**—**	**66**
- proceeds from shares issued		**—**	**4**	**—**	**1**	**5**	**—**	**5**
Dividends and other appropriations								
- ordinary shares		**—**	**—**	**—**	**(2,712)**	**(2,712)**	**—**	**(2,712)**
- to non-controlling interests		**—**	**—**	**—**	**—**	**—**	**(260)**	**(260)**
Purchase of own shares								
- held in employee share ownership trusts		**—**	**—**	**—**	**(49)**	**(49)**	**—**	**(49)**
- share buy-back programme		**—**	**—**	**—**	**(800)**	**(800)**	**—**	**(800)**
Non-controlling interests — acquisitions	29	**—**	**—**	**—**	**(4)**	**(4)**	**—**	**(4)**
Non-controlling interests — capital injection	26(c)	**—**	**—**	**—**	**—**	**—**	**4**	**4**
Other movements		**—**	**—**	**—**	**21**	**21**	**—**	**21**
Balance at 31 December 2014		**507**	**3,923**	**(498)**	**1,578**	**5,510**	**304**	**5,814**

	Notes	Attributable to owners of the parent						
	Notes	Share capital	Share premium, capital redemption and merger reserves	Other reserves	Retained earnings	Total attributable to owners of parent	Non-controlling interests	Total equity
		£m	£m	£m	£m	£m	£m	£m
Balance at 1 January 2013		507	3,916	796	2,253	7,472	307	7,779
Total comprehensive income for the year (page 122)		—	—	(986)	4,258	3,272	257	3,529
Profit for the year		—	—	—	3,904	3,904	295	4,199
Other comprehensive income for the year		—	—	(986)	354	(632)	(38)	(670)
Employee share options								
- value of employee services		—	—	—	61	61	—	61
- proceeds from shares issued		—	3	—	1	4	—	4
Dividends and other appropriations								
- ordinary shares		—	—	—	(2,611)	(2,611)	—	(2,611)
- to non-controlling interests		—	—	—	—	—	(271)	(271)
Purchase of own shares								
- held in employee share ownership trusts		—	—	—	(74)	(74)	—	(74)
- share buy-back programme		—	—	—	(1,509)	(1,509)	—	(1,509)
Non-controlling interests — capital injection	26(b)	—	—	—	—	—	8	8
Other movements		—	—	—	19	19	—	19
Balance at 31 December 2013		507	3,919	(190)	2,398	6,634	301	6,935

The accompanying notes are an integral part of the Group financial statements.

British American Tobacco, p.l.c.

Group Balance Sheet
At 31 December

	Notes	2014	2013
		£m	£m
Assets			
Non-current assets			
Intangible assets	9	**10,804**	11,205
Property, plant and equipment	10	**3,004**	3,156
Investments in associates and joint ventures	11	**2,400**	2,299
Retirement benefit assets	12	**40**	135
Deferred tax assets	13	**311**	248
Trade and other receivables	14	**153**	171
Available-for-sale investments	15	**36**	36
Derivative financial instruments	16	**287**	113
Total non-current assets		**17,035**	17,363
Current assets			
Inventories	17	**4,133**	4,042
Income tax receivable	18	**57**	95
Trade and other receivables	14	**2,768**	2,876
Available-for-sale investments	15	**50**	54
Derivative financial instruments	16	**274**	312
Cash and cash equivalents	19	**1,818**	2,106
		9,100	9,485
Assets classified as held-for-sale	26(d)	**32**	33
Total current assets		**9,132**	9,518
Total assets		**26,167**	26,881
Equity			
Capital and reserves			
Share capital		**507**	507
Share premium, capital redemption and merger reserves		**3,923**	3,919
Other reserves		**(498)**	(190)
Retained earnings		**1,578**	2,398
Owners of the parent		**5,510**	6,634
after deducting			
- cost of treasury shares		**(5,073)**	(4,325)
Non-controlling interests		**304**	301
Total equity	20	**5,814**	6,935
Liabilities			
Non-current liabilities			
Borrowings	21	**9,779**	9,716
Retirement benefit liabilities	12	**781**	632
Deferred tax liabilities	13	**495**	514
Other provisions for liabilities and charges	22	**278**	387
Trade and other payables	23	**128**	131
Derivative financial instruments	16	**123**	130
Total non-current liabilities		**11,584**	11,510
Current liabilities			
Borrowings	21	**2,479**	1,980
Income tax payable	18	**430**	487
Other provisions for liabilities and charges	22	**210**	194
Trade and other payables	23	**5,524**	5,741
Derivative financial instruments	16	**126**	34
Total current liabilities		**8,769**	8,436
Total equity and liabilities		**26,167**	26,881

The accompanying notes are an integral part of the Group financial statements.

On behalf of the Board

Richard Burrows
Chairman

25 February 2015

British American Tobacco, p.l.c.

Group Cash Flow Statement
For the year ended 31 December

	Notes	2014	2013
		£m	£m
Cash flows from operating activities			
Cash generated from operations	25	**4,634**	5,366
Dividends received from associates		**515**	510
Tax paid		**(1,433)**	(1,440)
Net cash generated from operating activities		**3,716**	4,436
Cash flows from investing activities			
Interest received		**61**	70
Dividends received from investments		**2**	2
Purchases of property, plant and equipment		**(529)**	(574)
Proceeds on disposal of property, plant and equipment	25	**62**	173
Purchases of intangibles		**(163)**	(147)
Purchases of investments	25	**(31)**	(47)
Proceeds on disposals of investments	25	**34**	15
Proceeds from associates' share buy-backs	25	**94**	189
Purchase of subsidiaries	25	**—**	(16)
Net cash used in investing activities		**(470)**	(335)
Cash flows from financing activities			
Interest paid		**(571)**	**(570)**
Interest element of finance lease rental payments		**—**	(1)
Capital element of finance lease rental payments		**(2)**	(2)
Proceeds from issue of shares to owners of the parent		**4**	3
Proceeds from the exercise of options over own shares held in employee share ownership trusts		**1**	1
Proceeds from increases in and new borrowings	25	**1,967**	2,428
Movements relating to derivative financial instruments	25	**244**	54
Purchases of own shares		**(800)**	(1,509)
Purchases of own shares held in employee share ownership trusts		**(49)**	(74)
Reductions in and repayments of borrowings	25	**(1,300)**	(1,421)
Dividends paid to owners of the parent	8	**(2,712)**	(2,611)
Purchases of non-controlling interests	25	**(4)**	—
Non-controlling interests — capital injection	25	**4**	—
Dividends paid to non-controlling interests		**(249)**	(265)
Net cash used in financing activities		**(3,467)**	(3,967)
Net cash flows (used in)/generated from operating, investing and financing activities		**(221)**	134
Differences on exchange		**(63)**	(197)
Decrease in net cash and cash equivalents in the year		**(284)**	(63)
Net cash and cash equivalents at 1 January		**1,776**	1,839
Net cash and cash equivalents at 31 December	19	**1,492**	1,776

The accompanying notes are an integral part of the Group financial statements.

The net cash outflows relating to adjusting items included in the above are £750 million (2013: £175 million).

British American Tobacco, p.l.c.

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 early adopted IFRS 10 *Consolidated Financial Statements,* IFRS 11 *Joint Arrangements* and IFRS 12 *Disclosure of Interests in Other Entities* with effect from 1 January 2013 along with the revised versions of IAS 27 *Separate Financial Statements* and IAS 28 *Investments in Associates and Joint Ventures.* These standards form a single package of proposals with mandatory application in the EU from 1 January 2014. The aim of these standards is to improve the quality of reporting in relation to the consolidation of subsidiaries, special purpose vehicles and accounting for joint arrangements.

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 budgeted cash flows of these 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 judgements made in conjunction with independent actuaries. These involve estimates about uncertain future events based on the environment in different countries, including life expectancy of scheme members, salary and pension increases, inflation, 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. The recognised deferred tax assets and liabilities, together with a note of unrecognised amounts, are shown in note 13, and a contingent tax asset is explained in note 6(b). 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 application of these accounting policies to the payments made and credits recognised under the Master Settlement Agreement by Reynolds American Inc. is described in note 5;
- the definition of adjusting items, which are separately disclosed as memorandum information, is explained below and the impact of these on the calculation of adjusted earnings is described in note 7;
- the estimation of the fair values of acquired net assets arising in a business combination and the allocation of the purchase consideration between the underlying net assets acquired, including intangible assets other than goodwill, on the basis of their fair values. These estimates are prepared in conjunction with the advice of independent valuation experts where appropriate. The relevant transactions for 2013 are described in note 26;
- the determination as to whether control (subsidiaries), joint control (joint arrangements), or significant influence (associates) exists in relation to the investments held by the Group. This is assessed after taking into account the Group's ability to appoint directors to the entity's board, its relative

shareholding compared with other shareholders, any significant contracts or arrangements with the entity or its other shareholders and other relevant facts and circumstances. The application of this judgement in respect of the Group's investment in Reynolds American Inc. is explained in note 11;

- the review of applicable exchange rates for transactions with and translation of entities in territories where there are restrictions on the free access to foreign currency, or multiple exchange rates; and
- the exemptions taken under IFRS 1 on the first time adoption of IFRS at 1 January 2004 and, in particular, those relating to goodwill on business combinations which are explained in the accounting policies below.

Such estimates and assumptions are based on historical experience and various other factors that are believed to be reasonable in the circumstances and constitute management's best judgement at the date of the financial statements. In the future, actual experience may deviate from these estimates and assumptions, which could affect the financial statements as the original estimates and assumptions are modified, as appropriate, in the year in which the circumstances change.

Basis of consolidation

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

A subsidiary is an entity controlled by the Group. The Group controls an entity when the Group is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity.

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

Joint arrangements comprise contractual arrangements where two or more parties have joint control and where decisions regarding the relevant activities of the entity require unanimous consent. Joint operations are jointly-controlled arrangements where the parties to the arrangement have rights to the underlying assets and obligations for the underlying liabilities relating to the arrangement. The Group accounts for its share of the assets, liabilities, income and expenses of any such arrangement. Joint ventures comprise arrangements where the parties to the arrangement have rights to the net assets of the arrangement. They are accounted for using the equity method.

The results of subsidiary undertakings acquired during the period are included from the date of acquisition of a controlling interest at which date, for the purposes of consolidation, the purchase consideration is allocated between the underlying net assets acquired, including intangible assets other than goodwill, on the basis of their fair value. Acquisition-related costs are expensed as incurred. Similarly, the results of associates and joint arrangements are included from the date of acquiring significant influence or joint control respectively.

The results of subsidiary undertakings, associates and joint arrangements which have been sold during the year are included up to the date of disposal. The profit or loss on sale is calculated by reference to the net asset value at the date of disposal, adjusted for purchased goodwill previously consolidated in the balance sheet.

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

Foreign currencies

The functional currency of the parent company is sterling and this is also the presentation currency of the Group. The income and cash flow statements of Group undertakings expressed in currencies other than sterling are translated to sterling using exchange rates applicable to the dates of the underlying transactions. Average rates of exchange in each year are used where the average rate approximates the relevant exchange rate at the date of the underlying transactions. Assets and liabilities of Group undertakings are translated at the applicable rates of exchange at the end of each year. In territories where there are restrictions on the free access to foreign currency or multiple exchange rates, the applicable rates of exchange are regularly reviewed.

For hyperinflationary countries, the financial statements in local currency are adjusted to reflect the impact of local inflation prior to translation into sterling.

The differences between retained profits of overseas subsidiary undertakings, associates and joint arrangements translated at average and closing rates of exchange are taken to reserves, as are differences arising on the retranslation to sterling (using closing rates of exchange) of overseas net assets at the beginning of the year. Any differences that have arisen since 1 January 2004 are presented as a separate component of equity. As permitted under IFRS 1 *First-time Adoption of International Financial Reporting Standards,* any differences prior to that date are not included in this separate component of equity.

Where a disposal of an investment in a Group undertaking results in a loss of control of a subsidiary undertaking, the loss of significant influence over an associated company or the loss of joint control over a joint arrangement, the cumulative amount of the related foreign exchange differences deferred in the separate component of equity are recognised in the income statement when the gain or loss on disposal is recognised. These related exchange differences comprise the exchange differences on all amounts deemed to be part of the net investment in the undertaking, which are recycled to the income statement when a disposal occurs. For partial disposals of subsidiary undertakings the related exchange differences are reclassified within equity. For all other partial disposals the proportional share of the related exchange differences is recycled to the income statement.

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

Revenue

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

Retirement benefit costs

The Group operates both defined benefit and defined contribution schemes. The net deficit or surplus for each defined benefit pension scheme is calculated in accordance with IAS 19 *Employee Benefits,* based on the present value of the defined benefit obligation at the balance sheet date less the fair value of the scheme assets adjusted, where appropriate, for any surplus restrictions or the effect of minimum funding requirements.

Actuarial gains and losses, changes in unrecognised scheme surpluses and minimum funding requirements are recognised in full through other comprehensive income. Past service costs or credits resulting from amendments to benefits are recognised immediately.

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

For defined benefit schemes, the actuarial cost charged to profit from operations consists of current service cost, net interest on the net defined benefit liability or asset, past service cost and the impact of any settlements.

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 arrangements operate and generate taxable income.

Deferred taxation is provided in full using the liability method for temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and the amount used for taxation purposes. Deferred tax is provided on temporary differences arising on investments in Group undertakings, except where the timing of the reversal of the temporary difference is controlled by the Group and it is probable that it will not reverse in the foreseeable future. A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. As required under IAS 12 *Income Taxes,* deferred tax assets and liabilities are not discounted.

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

Tax is recognised in the Income Statement except to the extent that it relates to items recognised in other comprehensive income or directly in equity, in which case it is recognised in other comprehensive income or changes in equity.

The Group has exposures in respect of the payment or recovery of a number of taxes. Liabilities or assets for these payments or recoveries are recognised at such time as an outcome becomes probable and when the amount can reasonably be estimated.

Goodwill

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

Goodwill represents the excess of the cost of acquisition of a subsidiary, associate or joint venture over the Group's share of the fair value of identifiable net assets acquired. Goodwill is stated at cost net of accumulated impairment losses and recognised amortisation prior to 1 January 2004. The Group's policy up to and including 1997 was to eliminate goodwill against reserves. Goodwill acquired from 1998 to 31 December 2003 was capitalised and amortised over its useful economic life.

As permitted under IFRS 1 *First-time Adoption of International Financial Reporting Standards,* in respect of acquisitions prior to 1 January 2004, the classification and accounting treatment of business combinations was not amended on transition to IFRS. Goodwill previously written off direct to reserves is not recycled to the Income Statement on the disposal of the subsidiary, associate or joint venture to which it relates.

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

Intangible assets other than goodwill

The intangible assets shown on the Group Balance Sheet consist mainly of trademarks and similar intangibles, including certain intellectual property, acquired by the Group's subsidiary undertakings and computer software.

Acquired trademarks and similar assets are carried at cost less accumulated amortisation and impairment. Trademarks with indefinite lives are not amortised but are reviewed annually for impairment. Intangible assets other than goodwill classified as held-for-sale are not amortised. Other trademarks and similar assets are amortised on a straight-line basis over their remaining useful lives, consistent with the pattern of economic benefits expected to be received, which do not exceed 20 years. Any impairments of trademarks are recognised in the Income Statement but increases in trademark values are not recognised.

Computer software is carried at cost less accumulated amortisation and impairment, and, with the exception of global software solutions, is amortised on a straight-line basis over periods ranging from three years to five years. Global software solutions are software assets designed to be implemented on a global basis and used as a standard solution by all of the operating companies in the Group. These assets are amortised on a straight-line basis over periods not exceeding 10 years.

The investments in associates and joint ventures shown in the Group Balance Sheet include trademarks arising from the combination of Brown & Williamson (B&W) and R J Reynolds (RJR) in 2004 to form Reynolds American Inc. (RAI), as well as those arising on the acquisition of Conwood by RAI in 2006. As the combination of B&W and RJR for the Group involved the partial disposal of B&W and an investment in RAI, fair values were assigned to trademarks formerly owned by RJR but not to those formerly owned by B&W. Most of the carrying value of the trademarks relates to trademarks which are deemed to have indefinite lives and each trademark is subject to an annual impairment test. Certain minor trademarks are being amortised over their remaining lives.

Property, plant and equipment

Property, plant and equipment are stated at cost less accumulated depreciation and impairment. Depreciation is calculated on a straight-line basis to write off the assets over their useful economic life. No depreciation is provided on freehold land or assets classified as held for sale. Freehold and leasehold property are depreciated at rates between 2.5% and 4% per annum, and plant and equipment at rates between 7% and 25% per annum.

Capitalised interest

Borrowing costs which are directly attributable to the acquisition, construction or production of intangible assets or plant, property and equipment that takes a substantial period of time to get ready for its intended use or sale, and for which the commencement date for capitalisation was on or after 1 January 2009, are capitalised as part of the cost of the asset, in accordance with IAS 23 *Borrowing Costs.* The Group's previous policy was to expense such borrowing costs as they were incurred.

Leased assets

Assets where the Group has substantially all the risks and rewards of ownership of the leased asset are classified as finance leases and are included as part of property, plant and equipment. Finance lease assets are initially recognised at an amount equal to the lower of their fair value and the present value of the minimum lease payments at inception of the lease, then depreciated over the shorter of the lease term and their estimated useful lives. Leasing payments consist of capital and finance charge elements and the finance element is charged to the Income Statement.

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

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

Impairment of non-financial assets

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

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

Impairment of financial assets

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

Inventories

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

Financial instruments

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

Financial assets and financial liabilities are initially recognised at fair value, plus directly attributable transaction costs where applicable, with subsequent measurement as set out below.

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

Available-for-sale investments

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

Loans and receivables

These are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market.

Cash and cash equivalents

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

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 primarily a single product business providing cigarettes and other tobacco products. While the Group has clearly differentiated brands, global segmentation between a wide portfolio of brands is not part of the regular internally reported financial information. The results of next-generation products are not currently material to the Group.

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

Adjusting items

Adjusting items are significant items in the profit from operations, net finance costs, taxation and the Group's share of the post-tax results of associates and joint ventures which individually or, if of a similar type, in aggregate, are relevant to an understanding of the Group's underlying financial performance. While the disclosure of adjusting items is not required by IFRS, these items are separately disclosed either as memorandum information on the face of the Income Statement and in the segmental analyses, or in the Notes to the Accounts as appropriate.

The Group believes that these items are useful to users of the Group financial statements in helping them to understand the underlying business performance and are used to derive the Group's principal non-GAAP measures of adjusted profit from operations and adjusted diluted earnings per share.

Provisions

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

Contingent liabilities and contingent assets

Subsidiaries and associates companies are defendants in tobacco-related and other litigation. Provision for this litigation (including legal costs) 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.

Where a provision has not been recognised, the Group records its external legal fees and other external defence costs for tobacco-related and other litigation as these costs are incurred.

Repurchase of share capital

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

Future changes to accounting policies

Certain changes to IFRS will be applicable to the Group financial statements in future years. Set out below are those which are considered to be most relevant to the Group.

IFRS 9 *Financial Instruments.* This standard was finalised and published in July 2014 as the replacement for IAS 39 *Financial Instruments: Recognition and Measurement.* Further due diligence will be carried out before implementation, but the anticipated impact from restatement on the Group's reported profit and equity for 2014 and 2013 is not expected to be material. The Standard is largely retrospective in application. Subject to EU endorsement, the expected mandatory effective date of implementation is 1 January 2018.

IFRS 15 *Revenue from Contracts with Customers.* This standard was finalised and published in May 2014 and harmonises IFRS and US GAAP with a single revenue recognition standard. Further due diligence will be carried out before implementation, but the anticipated impact from restatement on the Group's operating profit for 2014 and 2013 is not expected to be material. However, this standard may require changes to the allocation of costs between operating expenses and deductions from revenue, for example, payments to customers currently classed as expenses. The Standard is retrospective in application. Subject to EU endorsement, the expected mandatory effective date of implementation is 1 January 2017.

In addition, a number of other interpretations and revisions to existing standards have been issued which will be applicable to the Group's financial statements in future years, but will not have a 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 to the overall business. The results of next-generation products as a separate segment are currently not material to the Group and are included within the Western Europe region. Interest income, interest expense and taxation are centrally managed and accordingly such items are not presented by segment as they are excluded from the measure of segment profitability.

The four geographic regions are the reportable segments for the Group as they form the focus of the Group's internal reporting systems and are the basis used by the Management Board for assessing performance and allocating resources.

The Management Board reviews current and prior year segmental revenue, adjusted profit from operations of subsidiaries and joint operations, and adjusted post-tax results of associates and joint ventures at constant rates of exchange. The constant rate comparison provided for reporting segment information is based on a retranslation, at prior year exchange rates, of the current year results of the Group, including inter-company royalties payable in foreign currency to UK entities. Other than in exceptional circumstances, which will be fully disclosed, it does not adjust for the normal transactional gains and losses in operations which are generated by movements in exchange rates. As a result, the 2014 segmental results were translated using the 2013 rates of exchange. The 2013 figures are stated at the 2013 rates of exchange and are, therefore, unadjusted from those published for 2013.

The analyses of revenue for the 12 months to 31 December 2014 and 31 December 2013, based on location of sales, are as follows:

	2014			2013
	Revenue Constant rates	Translation exchange	Revenue Current rates	Revenue
	£m	£m	£m	£m
Asia-Pacific	**4,253**	**(380)**	**3,873**	4,203
Americas	**3,506**	**(516)**	**2,990**	3,317
Western Europe	**3,546**	**(187)**	**3,359**	3,635
EEMEA	**4,377**	**(628)**	**3,749**	4,105
Revenue	**15,682**	**(1,711)**	**13,971**	15,260

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:

	2014					2013		
	Adjusted* segment result Constant rates	Translation exchange	Adjusted* segment result Current rates	Adjusting items	Segment result Current rates	Adjusted* segment result	Adjusting items	Segment result
	£m	£m	£m	£m	£m	£m	£m	£m
Asia-Pacific	**1,713**	**(165)**	**1,548**	**(188)**	**1,360**	1,693	(21)	1,672
Americas	**1,475**	**(189)**	**1,286**	**(89)**	**1,197**	1,364	(61)	1,303
Western Europe	**1,262**	**(73)**	**1,189**	**(171)**	**1,018**	1,273	(140)	1,133
EEMEA	**1,625**	**(245)**	**1,380**	**(62)**	**1,318**	1,490	(72)	1,418
	6,075	**(672)**	**5,403**	**(510)**	**4,893**	5,820	(294)	5,526
Fox River**				**27**	**27**		—	—
Flintkote**				**(374)**	**(374)**		—	—
Profit from operations	**6,075**	**(672)**	**5,403**	**(857)**	**4,546**	5,820	(294)	5,526
Net finance costs	**(456)**	**39**	**(417)**	**—**	**(417)**	(466)	—	(466)
Asia-Pacific	**304**	**(27)**	**277**	**14**	**291**	272	22	294
Americas	**453**	**(22)**	**431**	**(7)**	**424**	445	(6)	439
EEMEA	**5**	**(1)**	**4**	**—**	**4**	6	—	6
Share of post-tax results of associates and joint ventures	**762**	**(50)**	**712**	**7**	**719**	723	16	739
Profit before taxation	**6,381**	**(683)**	**5,698**	**(850)**	**4,848**	6,077	(278)	5,799

* 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(i) and in note 5, respectively.

** The Fox River credit in 2014 (see note 3(h) and note 30) and the Flintkote charge in 2014 (see note 3(i) and note 30) have not been allocated to any segment as they neither relate to current operations nor the tobacco business. They are presented separately from the segmental reporting which is used to evaluate segment performance and to allocate resources, and is reported to the chief operating decision maker on this basis.

Adjusted profit from operations at constant rates of £6,075 million (2013: £5,820 million) excludes certain depreciation, amortisation and impairment charges as explained in notes 3(b), 3(e) and 3(f). These are excluded from segmental profit from operations at constant rates as follows:

	2014					2013		
	Adjusted depreciation, amortisation and impairment Constant rates	Translation exchange	Adjusted depreciation, amortisation and impairment Current rates	Adjusting items	Depreciation, amortisation and impairment Current rates	Adjusted depreciation, amortisation and impairment	Adjusting items	Depreciation, amortisation and impairment
	£m	£m	£m	£m	£m	£m	£m	£m
Asia-Pacific	**102**	**(6)**	**96**	**52**	**148**	90	17	107
Americas	**119**	**(13)**	**106**	**17**	**123**	96	17	113
Western Europe	**100**	**(4)**	**96**	**50**	**146**	102	37	139
EEMEA	**112**	**(14)**	**98**	**8**	**106**	104	14	118
	433	**(37)**	**396**	**127**	**523**	392	85	477

External revenue and non-current assets other than financial instruments, deferred tax assets and retirement benefit assets are analysed between the UK and all foreign countries at current rates of exchange as follows:

	United Kingdom		All foreign countries		Group	
	2014	2013	2014	2013	2014	2013
	£m	£m	£m	£m	£m	£m
Revenue is based on location of sale						
External revenue	**143**	155	**13,828**	15,105	**13,971**	15,260

	United Kingdom		All foreign countries		Group	
	2014	**2013**	**2014**	**2013**	**2014**	**2013**
	£m	**£m**	**£m**	**£m**	**£m**	**£m**
Intangible assets	**499**	417	**10,305**	10,788	**10,804**	11,205
Property, plant and equipment	**343**	357	**2,661**	2,799	**3,004**	3,156
Investments in associates and joint ventures	—	—	**2,400**	2,299	**2,400**	2,299

The only foreign operation requiring separate disclosure under the requirements of IFRS 8 *Operating Segments* is Souza Cruz operating in Brazil. The results of Souza Cruz are not disclosed separately in this Segmental analysis as they are disclosed in note 31 due to the materiality of the non-controlling interests. The main acquisitions comprising the goodwill balance of £9,842 million (2013: £10,249 million), included in intangible assets, are provided in note 9. Included in investments in associates and joint ventures are amounts of £1,361 million (2013: £1,447 million) attributable to the investment in Reynolds American Inc. and £991 million (2013: £808 million) attributable to the investment in ITC Ltd. Further information is provided in note 11.

3 Profit from operations

(a) Employee benefit costs

	2014	**2013**
	£m	**£m**
Wages and salaries	**1,776**	1,914
Social security costs	**212**	234
Other pension and retirement benefit costs (note 12)	**132**	162
Share-based payments — equity-settled (note 27)	**66**	61
Share-based payments — cash-settled (note 27)	**8**	13
	2,194	2,384

(b) Depreciation, amortisation and impairment costs

		2014	**2013**
		£m	**£m**
Intangibles	- amortisation of trademarks and similar intangibles (note 3(f))	**58**	74
	- amortisation of other intangibles	**58**	48
	- impairment	**11**	—
Property, plant and equipment	- depreciation	**307**	321
	- impairment	**89**	34
		523	477

Impairment in respect of certain property, plant and equipment is included in restructuring costs (see note 3(e)).

(c) Other operating income

This represents operating income arising from the Group's activities which falls outside the definition of revenue and includes gains as a result of property disposals, service fees and other shared costs charged to third parties, manufacturing fees and trademark income.

(d) Other operating expenses include:

	2014	2013
	£m	£m
Research and development expenses (excluding employee benefit costs and depreciation)	**74**	91
Exchange differences	**7**	11
Rent of plant and equipment (operating leases)		
- minimum lease payments	**28**	38
Rent of property (operating leases)		
- minimum lease payments	**69**	81
Fees payable for audit services pursuant to legislation:		
- fees payable to PricewaterhouseCoopers LLP for Parent Company and Group audit	**2.0**	1.8
- fees payable to other PricewaterhouseCoopers firms and associates for local statutory and Group reporting audits	**7.3**	7.6
Audit fees payable to PricewaterhouseCoopers firms and associates	**9.3**	9.4
Audit fees payable to other firms	**0.4**	0.5
Total audit fees payable	**9.7**	9.9
Fees payable to PricewaterhouseCoopers firms and associates for other services:		
- audit-related assurance services	**0.3**	0.3
- other assurance services	**0.1**	0.1
- tax advisory services	**3.8**	2.9
- tax compliance	**0.8**	1.0
- other non-audit services	**0.2**	0.6
	5.2	4.9

The total fees payable to PricewaterhouseCoopers firms and associates included above are £14.5 million (2013: £14.3 million).

Total research and development costs including employee benefit costs and depreciation are £154 million (2013: £161 million).

(e) Restructuring and integration costs

Restructuring costs reflect the costs incurred as a result of initiatives to improve the effectiveness and the efficiency of the Group as a globally integrated enterprise, including the relevant operating costs of implementing the new operating model. These costs represent additional expenses incurred which are not related to the normal business and day-to-day activities. The new operating model includes revised organisation structures, standardised processes and shared back office services underpinned by a global single instance of SAP. The new organisation structures and processes are currently being implemented and the deployment of the new SAP system started in the third quarter of 2012 and will take around a total of four years to fully roll-out. These initiatives also include a review of the Group's manufacturing operations, supply chain, overheads and indirect costs, organisational structure and systems and software used. The costs of these initiatives together with the costs of integrating acquired businesses into existing operations, including acquisition costs, are included in profit from operations under the following headings:

	2014	2013
	£m	£m
Employee benefit costs	**223**	140
Depreciation and impairment costs	**69**	11
Other operating expenses	**180**	161
Other operating income	**(20)**	(66)
	452	246

Restructuring and integration costs in 2014 principally relate to the restructuring initiatives directly related to implementation of a new operating model and the cost of packages in respect of permanent headcount reductions and permanent employee benefit reductions in the Group. The costs also cover factory closure and downsizing activities in Australia, Colombia and the Democratic Republic of Congo, and restructurings in Argentina, Indonesia, Canada, Switzerland and Germany.

Restructuring and integration costs in 2013 principally related to restructuring initiatives directly related to implementation of a new operating model and the continuation of the factory closure and downsizing activities in Australia and Russia, and restructuring of factories in the Democratic Republic of Congo, Switzerland and Germany. The costs also covered packages in respect of permanent headcount reductions and permanent employee benefit reductions in the Group.

Other operating income in 2014 includes gains from the sale of land and buildings in Turkey, Uganda and the Democratic Republic of Congo. In 2013, other operating income includes gains from the sale of land and buildings in Australia, Denmark and Russia.

(f) Amortisation of trademarks and similar intangibles

The acquisitions of Protabaco, Bentoel, Tekel, ST, CN Creative Limited and the creation of CTBAT International Limited (see note 26(a)) resulted in the capitalisation of trademarks and similar intangibles which are amortised over their expected useful lives, which do not exceed 20 years. The amortisation charge of £58 million (2013: £74 million) is included in depreciation, amortisation and impairment costs in profit from operations.

(g) Gain on deemed partial disposal of a trademark

The contribution of the State Express 555 brand to CTBAT International Limited in 2013 (see note 26(a)) is accounted for at fair value in the arrangement. This resulted in a £26 million gain on a deemed partial disposal of a trademark which is included in other operating income but has been treated as an adjusting item.

(h) Fox River

As explained in note 30, a Group subsidiary has certain liabilities in respect of indemnities given on the purchase and disposal of former businesses in the United States and in 2011, the Group provided £274 million in respect of claims in relation to environmental clean-up costs of the Fox River.

On 30 September 2014, a Group subsidiary, NCR, Appvion and Windward Prospects entered into the Funding Agreement with regard to the costs for Fox River. Based on this Funding Agreement, £56 million has been paid with legal costs incurred of £7 million. The Fox River provision has been reviewed and £27 million has been released in 2014 (see note 22 and note 30).

(i) Flintkote

As explained in note 30, in December 2014, a Group subsidiary entered into a settlement agreement in connection with various legal cases related to a former non-tobacco business in Canada. Under the terms of the settlement, the subsidiary will obtain protection from current and potential future Flintkote-related asbestos liability claims in the US. The settlement is contingent upon further documentation and approval of certain courts in the US. This agreement has led to a charge of £374 million in 2014.

4 Net finance costs

	2014 £m	2013 £m
Finance costs		
- interest payable		
- bonds and notes	**501**	518
- other loans and commercial paper	**22**	18
- bank loans and overdrafts	**56**	70
- finance leases	**—**	1
- facility fees	**9**	7
	588	614
- fair value changes on derivative financial instruments	**(154)**	(103)
- exchange differences on financial liabilities	**50**	21
	484	532
Finance income		
- interest and dividend income		
- dividend income in respect of available-for-sale investments	**(2)**	(2)
- other interest income	**(65)**	(62)
	(67)	(64)
- exchange differences on financial assets	**—**	(2)
	(67)	(66)
Net finance costs	**417**	466

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.

	2014 £m	2013 £m
Fair value changes		
- cash flow hedges transferred from equity	**(31)**	(6)
- fair value hedging instruments — exchange-related movements	**12**	(4)
- fair value hedging instruments — net interest income	**(83)**	(90)
- fair value hedging instruments — interest-related movements (note (i))	**(174)**	146
- fair value changes on hedged items — interest-related movements (note (i))	**158**	(151)
- instruments held-for-trading (note (ii))	**(36)**	2
	(154)	(103)
Finance costs — exchange differences on financial liabilities	**50**	21
Finance income — exchange differences on financial assets	**—**	(2)
	(104)	(84)

Notes:

(i) Hedge ineffectiveness in respect of fair value hedges is a £16 million gain (2013: £5 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 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.

Facility fees principally relate to the Group's central undrawn banking facilities of £3 billion and US$150 million (2013: £2 billion and US$150 million).

Exchange differences in respect of hedged items subject to fair value hedges and cash flow hedges were a gain of £12 million (2013: £4 million loss) and a loss of £36 million (2013: £14 million loss) respectively and are included in 'Finance costs — exchange differences' in the table above.

5 Associates and joint ventures

	2014		2013	
	Total	Group's share	Total	Group's share
	£m	£m	£m	£m
Gross turnover (including duty, excise and other taxes)	**12,219**	**4,576**	13,095	4,891
Duty, excise and other taxes	**(3,018)**	**(1,174)**	(3,961)	(1,485)
Revenue	**9,201**	**3,402**	9,134	3,406
Profit from operations	**3,166**	**1,163**	3,247	1,203
Net finance costs	**(169)**	**(70)**	(174)	(73)
Profit on ordinary activities before taxation	**2,997**	**1,093**	3,073	1,130
Taxation on ordinary activities	**(1,006)**	**(370)**	(1,037)	(387)
Profit on ordinary activities after taxation	**1,991**	**723**	2,036	743
Non-controlling interests	**(11)**	**(4)**	(11)	(4)
Post-tax results of associates and joint ventures	**1,980**	**719**	2,025	739
Analysed as:				
- adjusted share of post-tax results of associates and joint ventures	**1,951**	**712**	1,966	723
- issue of shares and change in shareholding	**46**	**14**	73	22
- restructuring and integration costs	**9**	**4**	(10)	(4)
- MSA receipts	**13**	**5**	79	33
- other	**(39)**	**(16)**	(83)	(35)
	1,980	**719**	2,025	739

(a) Adjusting items

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 2014, the Group's interest in ITC Ltd. (ITC) decreased from 30.47% to 30.26% as a result of ITC issuing ordinary shares under the company's Employee Share Option Scheme. The issue of these shares and change in the Group's share of ITC resulted in a gain of £14 million, which is treated as a deemed partial disposal and included in the Income Statement.

Reynolds American Inc. (RAI) recognised a net gain from discontinued activities of US$25 million, reduced by restructuring activities of US$16 million, resulting in a net gain of US$9 million. The Group's share of this net gain amounted to £4 million (net of tax).

As explained in note 5(b), under the Master Settlement Agreement (MSA) in the US, in June 2014, a further two states entered into a settlement agreement in relation to disputed NPM Adjustment Claims for the years 2003 to 2012. Under the settlement, RAI expects to receive more than US$170 million in MSA credits to be applied over five years. During 2014, RAI recognised income of US$34 million related to the 2013 liability as an adjusting item. The Group's share of this income amounted to £5 million (net of tax). Credits in respect of the 2014 liability and future years would be accounted for in the applicable year and will not be treated as adjusting items.

RAI has also recognised amounts which have been combined in the table of adjusting items in the Group Income Statement and are shown as 'other'. These are costs in respect of a number of Engle progeny lawsuits and other tobacco litigation charges that amount to US$102 million, the Group's share of which is £16 million (net of tax).

In 2013, the Group's interest in ITC decreased from 30.72% to 30.47% as a result of ITC issuing ordinary shares under the company's Employee Share Option Scheme. This resulted in a gain of £22 million, which was treated as a deemed partial disposal and included in the Income Statement.

During 2013, RAI recognised restructuring charges of US$24 million and the Group's share of these charges amounted to £4 million (net of tax).

During 2013, RAI recognised income of US$219 million related to its 2012 MSA liability as an adjusting item, the Group's share of which amounted to £33 million (net of tax). Credits in respect of the 2013 liability and future years would be accounted for in the applicable year and will not be treated as adjusting items.

In the year ended 31 December 2013, RAI recognised amounts which have been combined in the table of adjusting items and reported in 'other'. These consist of a charge of US$18 million in respect of a number of Engle progeny lawsuits, the Group's share of which amounted to £3 million (net of tax); costs of US$34 million relating to other tobacco-related litigation charges, the Group's share of which amounted to £6 million (net of tax); trademark amortisation and impairment of US$27 million, the Group's share of which amounted to £4 million (net of tax); and costs of US$124 million relating to losses on extinguishment of debt, the Group's share of which amounted to £22 million (net of tax).

(b) Master Settlement Agreement

In 1998, the major US cigarette manufacturers (including R J Reynolds and Brown & Williamson) entered into the Master Settlement Agreement (MSA) with attorney generals representing most US states and territories. The MSA imposes a perpetual stream of future payment obligations on the major US cigarette manufacturers. The amounts of money that the participating manufacturers are required to annually contribute are based upon, amongst other things, the volume of cigarettes sold and market share (based on cigarette shipments in that year). Given these facts, the Group's accounting for the MSA payments is to accrue for them in the cost of products sold as the products are shipped and no provision is made in respect of potential payments relating to future years. The event which gives rise to the obligation is the actual sales of products shipped and the MSA payments are therefore recognised as part of the costs of those business operations.

During 2013, RAI, various other tobacco manufacturers, 19 states, the District of Columbia and Puerto Rico reached a final agreement related to RAI's 2003 Master Settlement Agreement (MSA) activities. Under this agreement RAI will receive credits, currently estimated to be more than US$1 billion, in respect of its Non-Participating Manufacturer (NPM) Adjustment claims related to the period from 2003 to 2012. These credits will be applied against the company's MSA payments over a period of five years from 2013, subject to, and dependent upon, meeting the various ongoing performance obligations.

During 2014, two additional states agreed to settle NPM disputes related to claims for the period 2003 to 2012. It is estimated that RAI will receive US$170 million in credits, which will be applied over a five-year period from 2014.

(c) Other financial information

	2014 Group's share £m	2013 Group's share £m
Profit on ordinary activities after taxation		
- attributable to owners of the parent	**719**	739
Other comprehensive income:		
Differences on exchange	**113**	(141)
Net fair value gains/(losses) on available-for-sale investments	**15**	(7)
Actuarial (losses)/gains relating to pensions and other post-retirement benefits (note 20)	**(124)**	90
Total comprehensive income (note 11)	**723**	681

	2014 Group's share £m	2013 Group's share £m
Dividends received		
- listed investments	**510**	504
- unlisted investments	**8**	8
Total dividends received from associates	**518**	512

Summarised financial information of the Group's associates and joint ventures:

	2014				2013			
	RAI	ITC	Others	Total	RAI	ITC	Others	Total
	£m	£m	£m	£m	£m	£m	£m	£m
Revenue	**5,132**	**3,777**	**292**	**9,201**	5,268	3,557	309	9,134
Profit on ordinary activities before taxation	**1,551**	**1,389**	**57**	**2,997**	1,648	1,358	67	3,073
Post-tax results of associates and joint ventures	**1,000**	**938**	**42**	**1,980**	1,035	942	48	2,025
Other comprehensive income	**(166)**	**184**	**(29)**	**(11)**	130	(454)	34	(290)
Total comprehensive income	**834**	**1,122**	**13**	**1,969**	1,165	488	82	1,735

6 Taxation on ordinary activities

(a) Summary of taxation on ordinary activities

	2014	2013
	£m	£m
UK corporation tax	**—**	—
Overseas tax	**1,450**	1,567
Comprising:		
- current year tax expense	**1,439**	1,581
- adjustments in respect of prior periods	**11**	(14)
Total current tax	**1,450**	1,567
Deferred tax	**5**	33
Comprising:		
- deferred tax relating to origination and reversal of temporary differences	**7**	33
- deferred tax relating to changes in tax rates	**(2)**	—
	1,455	1,600

(b) Franked Investment Income Group Litigation Order

British American Tobacco is the principal test claimant in an action in the United Kingdom against HM Revenue and Customs in the Franked Investment Income Group Litigation Order (FII GLO). There are 25 corporate groups in the FII GLO. The case concerns the treatment for UK corporate tax purposes of profits earned overseas and distributed to the UK. The claim was filed in 2003 and the case was heard in the European Court of Justice (ECJ) in 2005 and a decision of the ECJ received in December 2006. In July 2008, the case reverted to a trial in the UK High Court for the UK Court to determine how the principles of the ECJ decision should be applied in a UK context.

The High Court judgement in November 2008 concluded, amongst other things, that the corporation tax provisions relating to dividend income from EU subsidiaries breached EU law. 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 creditable against advance corporation tax (ACT) liabilities with the consequence that ACT need not have been paid. Claims for the repayment of UK tax incurred where the dividends were from the EU were allowed back to 1973.

The case was heard by the Court of Appeal in October 2009 and the judgement handed down on 23 February 2010. The Court of Appeal determined that various questions, including which companies in the corporate tree can be included in a claim, should be referred back to the ECJ for further clarification. In addition, the Court determined that the claim should be restricted to six years and not cover claims dating back to 1973.

The issue of time limits was heard by the Supreme Court in February 2012 and in May 2012 the Supreme Court decided in British American Tobacco Group's favour, that claims submitted before 8 September 2003 can go back to 1973. A hearing took place in February 2012 at the ECJ on the questions referred from the Court of Appeal.

The ECJ judgement of 13 November 2012 confirms that the UK treatment of EU dividends was discriminatory and produces the same outcome for third country dividends from 1994 in certain circumstances. The judgement also confirms that the claim can cover dividends from all indirect as well as direct EU subsidiaries and also ACT paid by a superior holding company.

The detailed technical issues of the quantification mechanics of the claim were heard by the High Court during May and June 2014 and the judgement handed down on 18 December 2014. The High Court determined that in respect of issues concerning the calculation of unlawfully charged corporation tax and advanced corporation tax, the law of restitution including the defence on change of position and questions concerning the calculation of overpaid interest, the approach of the British American Tobacco Group was broadly preferred. The conclusion reached by the High Court would, if upheld, produce an estimated receivable of £1.2 billion for British American Tobacco. Appeals on a majority of the issues have been made to the Court of Appeal, which is likely to hear the case in 2016.

No potential receipt has been recognised in the current period or the prior year, in the results of the Group, due to the uncertainty of the amounts and eventual outcome.

(c) Factors affecting the taxation charge

The taxation charge differs from the standard 21% (2013: 23%) rate of corporation tax in the UK. The major causes of this difference are listed below:

	2014		**2013**	
	£m	**%**	**£m**	**%**
Profit before tax	**4,848**		5,799	
Less: share of post-tax results of associates and joint ventures	**(719)**		(739)	
	4,129		5,060	
Tax at 21% (2013: 23%) on the above	**867**	**21.0**	1,164	23.0
Factors affecting the tax rate:				
Tax at standard rates other than UK corporation tax rate	**236**	**5.7**	158	3.1
Other national tax charges	**69**	**1.7**	51	1.0
Permanent differences	**29**	**0.7**	6	0.1
Overseas withholding taxes	**157**	**3.8**	138	2.7
Double taxation relief on UK profits	**(9)**	**(0.2)**	(11)	(0.2)
Unutilised tax losses	**45**	**1.1**	62	1.2
Adjustments in respect of prior periods	**11**	**0.2**	(14)	(0.2)
Net deferred tax debits at other tax rates	**50**	**1.2**	46	0.9
	1,455	**35.2**	1,600	31.6

(d) Tax on adjusting items

The tax on adjusting items, separated between the different categories, as per note 7 to the accounts, amounted to £69 million (2013: £46 million), excluding outside shareholders' interests of £5 million (2013: £3 million).

(e) Tax on items recognised directly in other comprehensive income

	2014	**2013**
	£m	**£m**
Current tax	**17**	2
Deferred tax	**94**	(53)
Credited/(charged) to other comprehensive income	**111**	(51)

The tax relating to each component of other comprehensive income is disclosed in note 20.

7 Earnings per share

Basic earnings per share are based on profit for the year attributable to ordinary shareholders of £3,115 million (2013: £3,904 million) and 1,864 million (2013: 1,901 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 1,870 million (2013: 1,908 million) to reflect the potential dilutive effect of employee share schemes.

	2014			2013		
	Earnings	**Weighted average number of shares**	**Earnings per share**	**Earnings**	**Weighted average number of shares**	**Earnings per share**
	£m	**m**	**pence**	**£m**	**m**	**pence**
Basic earnings per share	**3,115**	**1,864**	**167.1**	3,904	1,901	205.4
Share options	**—**	**6**	**(0.5)**	—	7	(0.8)
Diluted earnings per share	**3,115**	**1,870**	**166.6**	3,904	1,908	204.6

Earnings have been affected by a number of adjusting items, which are described in notes 3 and 5. To illustrate the impact of these items, an adjusted earnings per share calculation is shown below.

Adjusted earnings per share calculation

		Diluted				Basic			
		2014		2013		2014		2013	
	Notes	**Earnings**	**Earnings per share**	**Earnings**	**Earnings per share**	**Earnings**	**Earnings per share**	**Earnings**	**Earnings per share**
		£m	**pence**	**£m**	**pence**	**£m**	**pence**	**£m**	**pence**
Unadjusted earnings per share		**3,115**	**166.6**	3,904	204.6	**3,115**	**167.1**	3,904	205.4
Effect of restructuring and integration costs	3(e)	**452**	**24.2**	246	12.9	**452**	**24.2**	246	12.9
Tax and non-controlling interests on restructuring and integration costs		**(67)**	**(3.6)**	(35)	(1.9)	**(67)**	**(3.6)**	(35)	(1.9)
Effect of amortisation of trademarks and similar intangibles	3(f)	**58**	**3.1**	74	3.9	**58**	**3.1**	74	3.9
Tax on amortisation of trademarks and similar intangibles		**(7)**	**(0.4)**	(14)	(0.7)	**(7)**	**(0.4)**	(14)	(0.7)
Gain on deemed partial disposal of a trademark	3(g)	**—**	**—**	(26)	(1.4)	**—**	**—**	(26)	(1.4)
Effect of Fox River	3(h)	**(27)**	**(1.4)**	—	—	**(27)**	**(1.4)**	—	—
Effect of Flintkote	3(i)	**374**	**20.0**	—	—	**374**	**20.1**	—	—
Effect of associates' adjusting items net of tax	5	**(7)**	**(0.4)**	(16)	(0.8)	**(7)**	**(0.4)**	(16)	(0.8)
Adjusted earnings per share		**3,891**	**208.1**	4,133	216.6	**3,891**	**208.7**	4,133	217.4

Headline earnings per share as required by the JSE Limited

The presentation of headline earnings per share, as an alternative measure of earnings per share, is mandated under the JSE Listing Requirements. It is calculated in accordance with Circular 2/2013 'Headline Earnings', as issued by the South African Institute of Chartered Accountants.

	Diluted				Basic			
	2014		2013		2014		2013	
	Earnings	Earnings per share	Earnings	Earnings per share	Earnings	Earnings per share	Earnings	Earnings per share
	£m	pence	£m	pence	£m	pence	£m	pence
Unadjusted earnings per share	**3,115**	**166.6**	3,904	204.6	**3,115**	**167.1**	3,904	205.4
Effect of impairment of intangibles, property, plant and equipment, and assets held-for-sale	**107**	**5.7**	34	1.8	**107**	**5.7**	34	1.8
Tax and non-controlling interests on impairment of intangibles, and property, plant and equipment	**(20)**	**(1.0)**	(2)	(0.1)	**(20)**	**(1.0)**	(2)	(0.1)
Effect of gains on disposal of property, plant and equipment and held-for-sale assets	**(34)**	**(1.9)**	(92)	(4.8)	**(34)**	**(1.8)**	(92)	(4.8)
Tax and non-controlling interests on disposal of property, plant and equipment and held-for-sale assets	**9**	**0.5**	25	1.3	**9**	**0.5**	25	1.3
Effect of disposal of businesses and trademarks	**—**	**—**	(26)	(1.4)	**—**	**—**	(26)	(1.4)
Effect of gains reclassified from the available-for-sale reserve	**—**	**—**	(2)	(0.1)	**—**	**—**	(2)	(0.1)
Share of associates' trademark and other asset impairments net of tax	**—**	**—**	4	0.2	**—**	**—**	4	0.2
Issue of shares and change in shareholding in associate	**(14)**	**(0.8)**	(22)	(1.1)	**(14)**	**(0.8)**	(22)	(1.2)
Headline earnings per share	**3,163**	**169.1**	3,823	200.4	**3,163**	**169.7**	3,823	201.1

An alternative measure of headline earnings per share has been presented below to take account of the effects of Fox River (note 3(h)) and Flintkote (note (3(i)); this measure is in addition to and not mandated by the JSE Listing Requirements:

Headline earnings per share amended for Fox River and Flintkote	**3,510**	**187.7**	3,823	200.4	**3,510**	**188.4**	3,823	201.1

8 Dividends and other appropriations

	2014		2013	
	Pence per share	£m	Pence per share	£m
Ordinary shares				
Interim				
2014 paid 30 September 2014	**47.5**	**881**		
2013 paid 30 September 2013			45.0	846
Final				
2013 paid 8 May 2014	**97.4**	**1,831**		
2012 paid 8 May 2013			92.7	1,765
	144.9	**2,712**	137.7	2,611

The Directors have recommended to shareholders a final dividend of 100.6p per share for the year ended 31 December 2014. If approved, this dividend will be paid to shareholders on 7 May 2015. This dividend is subject to approval by shareholders at the Annual General Meeting and therefore, in accordance with IAS 10 *Events After the Reporting Period,* it has not been included as a liability in these financial statements. The total estimated dividend to be paid is £1,866 million, which takes the total dividends declared in respect of 2014 to £2,747 million (2013: £2,677 million) representing 148.1p per share (2013: 142.4p per share).

9 Intangible assets

	Goodwill*	Computer software	Trademarks and similar intangibles	Assets in the course of development	Total
	£m	£m	£m	£m	£m
1 January 2014					
Cost	**10,249**	**631**	**891**	**283**	**12,054**
Accumulated amortisation and impairment		**(496)**	**(353)**		**(849)**
Net book value at 1 January 2014	**10,249**	**135**	**538**	**283**	**11,205**
Differences on exchange	**(407)**	**(3)**	**(31)**	**—**	**(441)**
Additions					
- internal development	**—**	**16**	**—**	**143**	**159**
- separately acquired	**—**	**4**	**3**	**—**	**7**
Reallocations	**—**	**121**	**—**	**(121)**	**—**
Amortisation charge	**—**	**(56)**	**(58)**	**—**	**(114)**
Impairment	**—**	**(12)**	**—**	**—**	**(12)**
31 December 2014					
Cost	**9,842**	**735**	**844**	**305**	**11,726**
Accumulated amortisation and impairment		**(530)**	**(392)**		**(922)**
Net book value at 31 December 2014	**9,842**	**205**	**452**	**305**	**10,804**
1 January 2013					
Cost	10,793	659	904	173	12,529
Accumulated amortisation and impairment		(509)	(310)		(819)
Net book value at 1 January 2013	10,793	150	594	173	11,710
Differences on exchange	(545)	(1)	(21)	(4)	(571)
Additions					
- internal development	—	14	—	133	147
- acquisitions (note 26(b))	1	—	25	—	26
- separately acquired	—	3	10	—	13
Reallocations	—	19	—	(19)	—
Amortisation charge	—	(50)	(70)	—	(120)
31 December 2013					
Cost	10,249	631	891	283	12,054
Accumulated amortisation and impairment		(496)	(353)		(849)
Net book value at 31 December 2013	10,249	135	538	283	11,205

* The cost of Goodwill is shown net of impairment charges made in prior years.

Included in computer software and assets in the course of development are internally developed assets with a carrying value of £493 million (2013: £398 million). The costs of internally developed assets include capitalised expenses of employees working full time on software development projects, third-party consultants, as well as software licence fees from third-party suppliers.

Acquisitions in 2013 related to the creation of CTBAT International Limited and the acquisition of British American Tobacco Myanmar Limited as explained in note 26.

Included in the net book value of trademarks and similar intangibles are trademarks relating to the acquisition of Skandinavisk Tobakskompagni (ST) £262 million (2013: £301 million), Tekel £25 million (2013: £30 million), Bentoel £30 million (2013: £38 million) and Protabaco £72 million (2013: £91 million) and intellectual property of £13 million (2013: £26 million) relating to the acquisition of CN Creative Limited in 2012.

The Group has future contractual commitments of £10 million (2013: £11 million) related to intangible assets.

Impairment testing for intangible assets with indefinite lives including goodwill

Goodwill of £9,842 million (2013: £10,249 million) is included in intangible assets in the balance sheet of which the following are the significant acquisitions: Rothmans Group £4,384 million (2013: £4,542 million); Imperial Tobacco Canada £2,223 million (2013: £2,281 million); ETI (Italy) £1,280 million (2013: £1,371 million) and ST (principally Scandinavia) £963 million (2013: £1,030 million). The principal allocations of goodwill in the Rothmans' acquisition are to the cash-generating units of Eastern Europe, Western Europe and South Africa, with the remainder mainly relating to operations in the domestic and export markets in the United Kingdom and operations in Asia-Pacific.

In 2014 and 2013, goodwill was allocated for impairment testing purposes to 14 individual cash-generating units — five in Asia-Pacific, five in the Americas, two in Western Europe and two in EEMEA.

The carrying amounts of goodwill allocated to the cash-generating units of Canada £2,223 million (2013: £2,281 million), Western Europe (includes Rothmans and other acquisitions) £3,388 million (2013: £3,624 million), Eastern Europe (includes Rothmans and other acquisitions) £851 million (2013: £908 million), South Africa £614 million (2013: £639 million), Australia (includes Rothmans and other acquisitions) £703 million (2013: £724 million), Singapore £517 million (2013: £511 million) and Malaysia £432 million (2013: £434 million) are considered significant in comparison with the total carrying amount of goodwill.

The recoverable amounts of all cash-generating units have been determined on a value-in-use basis. The key assumptions for the recoverable amounts of all units are the budgeted volumes, operating margins and long-term growth rates, which directly impact the cash flows, and the discount rates used in the calculation. 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. The long-term growth rates and discount rates have been applied to the budgeted cash flows of each cash-generating unit. These cash flows have been determined by local management based on experience, specific market and brand trends, pricing expectations and costs, and have been endorsed by Group management as part of the consolidated Group budget.

The valuations use cash flows based on detailed financial budgets prepared by management covering a one-year period, with growth in year 2 of 5% (2013: 6%). Cash flows for the years 3 to 10 are extrapolated from year 2 cash flows of each relevant operating unit at 4% (2013: 5%) per annum, including 1% (2013: 2%) inflation, where after a total growth rate of 2% (2013: 2%) per annum (including 2% (2013: 2%) inflation) has been assumed. The extrapolated growth rates are considered conservative given the Group's history of profit and cash growth, its well balanced portfolio of brands and the industry in which it operates. The long-term real growth does not exceed the expected long-term average growth rate for the combined markets in which the cash-generating units operate. In some instances, such as recent acquisitions or start-up ventures, the valuation is expanded to reflect the medium-term plan of the country or market management, spanning five years or beyond.

Pre-tax discount rates of between 7.2% and 15.0% (2013: 7.2% to 14.1%) were used, based on the Group's weighted average cost of capital, together with any premium applicable for economic and political risks.

The pre-tax discount rates used for the cash-generating units which are significant in comparison with the total carrying amount of goodwill are 8.5% for Canada (2013: 8.5%), 8.6% for Western Europe (2013: 9.3%), 8.5% for Eastern Europe (2013: 8.6%), 9.6% for South Africa (2013: 9.3%), 8.6% for Australia (2013: 8.6%), 7.2% for Singapore (2013: 7.2%) and 8.7% for Malaysia (2013: 8.7%).

If discounted cash flows for cash-generating units should fall by 10%, or the discount rate was increased at a post-tax rate of 1%, there would be no impairment.

10 Property, plant and equipment

	Freehold property	Leasehold property	Plant and equipment	Assets in the course of construction	Total
	£m	£m	£m	£m	£m
1 January 2014					
Cost	**1,034**	**258**	**4,257**	**527**	**6,076**
Accumulated depreciation and impairment	**(325)**	**(123)**	**(2,460)**	**(12)**	**(2,920)**
Net book value at 1 January 2014	**709**	**135**	**1,797**	**515**	**3,156**
Differences on exchange	**(45)**	**(1)**	**(138)**	**(33)**	**(217)**
Additions	**9**	**1**	**74**	**414**	**498**
Reallocations	**55**	**12**	**274**	**(341)**	**—**
Depreciation	**(20)**	**(9)**	**(278)**	**—**	**(307)**
Impairment	**(40)**	**(8)**	**(36)**	**(3)**	**(87)**
Disposals	**(13)**	**(2)**	**(12)**	**(1)**	**(28)**
Net reclassifications as held-for-sale	**—**	**—**	**(11)**	**—**	**(11)**
31 December 2014					
Cost	**998**	**260**	**4,109**	**570**	**5,937**
Accumulated depreciation and impairment	**(343)**	**(132)**	**(2,439)**	**(19)**	**(2,933)**
Net book value at 31 December 2014	**655**	**128**	**1,670**	**551**	**3,004**
1 January 2013					
Cost	1,138	261	4,453	483	6,335
Accumulated depreciation and impairment	(362)	(123)	(2,649)		(3,134)
Net book value at 1 January 2013	776	138	1,804	483	3,201
Differences on exchange	(47)	(6)	(137)	(37)	(227)
Additions*	12	16	117	420	565
Reallocations	24	(4)	314	(334)	—
Depreciation	(22)	(9)	(270)	—	(301)
Impairment	(2)	—	(14)	(17)	(33)
Disposals	(32)	—	(17)	—	(49)
31 December 2013					
Cost	1,034	258	4,257	527	6,076
Accumulated depreciation and impairment	(325)	(123)	(2,460)	(12)	(2,920)
Net book value at 31 December 2013	709	135	1,797	515	3,156
Assets held under finance leases					
31 December 2014					
Cost			**17**		**17**
Accumulated depreciation and impairment			**(8)**		**(8)**
Net book value at 31 December 2014			**9**		**9**
31 December 2013					
Cost			13		13
Accumulated depreciation and impairment			(8)		(8)
Net book value at 31 December 2013			5		5

* Additions in 2013 include amounts contributed by the non-controlling interest in Myanmar (note 26).

The Group's finance lease arrangements relate principally to the lease of vehicles and tobacco vending machines by the Group's subsidiaries in Pakistan and Japan respectively. Assets held under finance leases are secured under finance lease obligations included in note 21.

As explained in note 12, contributions to the British American Tobacco UK Pension Fund are secured by a charge over the Group's Head Office (Globe House). Globe House is included in freehold property above with a carrying value of £191 million (2013: £192 million).

	2014 £m	2013 £m
Cost of freehold land within freehold property on which no depreciation is provided	**200**	203
Leasehold property comprises		
- net book value of long leasehold	**113**	111
- net book value of short leasehold	**15**	24
	128	135
Contracts placed for future expenditure	**121**	82

11 Investments in associates and joint ventures

	2014 £m	2013 £m
1 January	**2,299**	2,330
Total comprehensive income (note 5)	**723**	681
Dividends (note 5)	**(518)**	(512)
Share buy-backs (note 25(d))	**(94)**	(189)
Other equity movements	**(10)**	(11)
31 December	**2,400**	2,299
Non-current assets	**4,070**	3,741
Current assets	**1,798**	1,667
Non-current liabilities	**(2,099)**	(1,983)
Current liabilities	**(1,369)**	(1,126)
	2,400	2,299
Reynolds American Inc. (Group's share of the market value is £9,205 million (2013: £6,828 million))	**1,361**	1,447
ITC Ltd. (Group's share of the market value is £9,001 million (2013: £7,587 million))	**991**	808
Other listed associates (Group's share of the market value is £98 million (2013: £83 million))	**13**	11
Unlisted associates	**35**	33
	2,400	2,299

The principal associate undertakings of the Group are Reynolds American Inc (RAI) and ITC Ltd. (ITC) as shown under principal associate undertakings.

Reynolds American Inc.

	2014 £m	2013 £m
Non-current assets	**4,481**	4,146
Current assets	**2,193**	2,257
Non-current liabilities	**(4,838)**	(4,576)
Current liabilities	**(2,162)**	(1,739)
	(326)	88
Group's share of Reynolds American Inc. (42.0%)	**(137)**	37
Goodwill	**1,498**	1,410
Total Group's share of Reynolds American Inc.	**1,361**	1,447

On 30 July 2004, the Group completed the agreement to combine the US domestic business of Brown and Williamson (B&W), one of its subsidiaries, with RJ Reynolds. This combination resulted in the formation of RAI, which is 58% owned by RJ Reynolds' shareholders and 42% owned by the Group. The Group has concluded that it does not have de facto control of RAI because of the operation of the governance agreement between the Group and RAI which ensures that the Group does not have the practical ability to direct the relevant activities of RAI; in particular, the Group cannot nominate more than five of the Directors (out of 13 or

proportionally less if there are less than 13 Directors) unless it owns 100% of RAI or some other party owns more than 50%. In addition, there are no other contractual arrangements which would give the Group the ability to direct RAI's operations. Manufacturing and cooperation agreements between RAI and the Group have been agreed on an arm's length basis (see note 29).

The Group's share of RAI includes £472 million (2013: £446 million) of trademarks arising from the RAI transaction in 2004. In addition, the Group's share of non-current assets includes £667 million (2013: £628 million) of goodwill and £308 million (2013: £291 million) of trademarks arising from the acquisition of Conwood by RAI in 2006.

Details of the Group's contingent liabilities are set out in note 30. In addition to US litigation involving Group companies, which is covered by the R.J. Reynolds Tobacco Company (RJRT) indemnity referred to in note 30, RAI group companies are named in litigation which does not involve Group companies. While it is impossible to be certain of the outcome of any particular case or of the amount of any possible adverse verdict, it is not impossible that the results of operations or cash flows of RAI, in particular quarterly or annual periods, could be materially affected by this and by the final outcome of any particular litigation. However, having regard to the contingent liability disclosures on litigation made by RAI in its public financial reports, the Directors are satisfied with the carrying value included above for RAI.

The Group's share of the RAI results for the year to 31 December 2014 includes £46 million (2013: £43 million) in respect of external legal fees and other external product liability defence costs.

On 15 July 2014, the Group announced that it has agreed to invest US$4.7 billion as part of RAI's proposed acquisition of Lorillard enabling the Group to maintain its 42% equity position in the enlarged business. The investment is contingent upon the completion of RAI's acquisition of Lorillard, which has been approved by the shareholders of RAI and Lorillard, and the proposed acquisition, while subject to a number of regulatory approvals in the US, is anticipated to be completed in the first half of 2015.

ITC Ltd

ITC prepares accounts on a quarterly basis with a 31 March year-end. As permitted by IAS 28 *Investments in Associates and Joint Ventures,* results up to 30 September 2014 have been used in applying the equity method. This is driven by the availability of information at the half year, to be consistent with the treatment in the Group's interim accounts. Any further information available after the date used for reporting purposes is reviewed and any material items adjusted for in the final results. The latest published information available is at 31 December 2014.

	2014 £m	2013 £m
Non-current assets	**2,201**	1,858
Current assets	**2,713**	2,202
Non-current liabilities	**(212)**	(194)
Current liabilities	**(1,428)**	(1,214)
	3,274	2,652
Group's share of ITC Ltd (2014: 30.26% (2013: 30.47%))	**991**	808

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 170 retirement benefit arrangements worldwide. The majority of scheme members belong to defined benefit schemes, most of which are funded externally and many of which are closed to new entrants. The Group also operates a number of defined contribution schemes.

The liabilities arising in the defined benefit schemes are determined in accordance with the advice of independent, professionally qualified actuaries, using the projected unit credit method. All schemes are formally valued at least every three years.

The principal schemes are in the UK, Germany, Canada, the Netherlands and Switzerland. Together schemes in these territories account for over 85% of the total obligations of the Group's defined benefit schemes. These obligations consist mainly of final salary pension schemes which provide benefits to members in the form of a guaranteed level of pension payable for life. The level of benefits provided depends on members' length of service and their salary in the final years leading up to retirement. As a result of regulatory changes, with effect from 1 January 2015, the schemes in the Netherlands now accrue benefits based on lifetime average salaries.

In addition, the Group operates several health care benefit schemes, of which the most significant are in Canada. The liabilities in respect of healthcare benefits are also assessed by qualified independent actuaries, applying the projected unit credit method.

All of these arrangements, including funded schemes where formal trusts or equivalents are required, have been developed and are operated in accordance with local practices and regulations where applicable in the countries concerned. For example, in the UK, the main pension scheme is the British American Tobacco UK Pension Fund, which is established under trust law and has a corporate trustee that is required to run the scheme in accordance with the Scheme's Trust Deed and Rules and to comply with the Pension Scheme Act 1993, Pensions Act 1995, Pension Act 2004 and all the relevant legislation.

Responsibility for the governance of the schemes, including investment decisions and contribution schedules, lies with the trustees. The trustees for each arrangement will usually consist of representatives appointed by both the sponsoring company and the beneficiaries.

The majority of schemes are subject to local regulation regarding funding deficits. Contributions to defined benefit schemes are determined after consultation with the respective trustees and actuaries of the individual externally funded schemes and after taking into account regulatory requirements.

Contributions to the British American Tobacco UK Pension Fund have been agreed with the trustee as part of a recovery plan to include £30 million a year to cover ongoing service costs and additional contributions to eliminate a funding shortfall. Additional contributions were £140 million in 2014 and £190 million in 2013 and are planned to be £148 million in 2015, and £78 million in each of 2016, 2017 and 2018. These contributions will be used to achieve the statutory funding objective and thereafter to support attaining a lower risk investment strategy (noted below) and may be subject to renegotiation, dependent on funding levels. Total contributions payable are secured by a charge over the Group's Head Office (Globe House) up to a maximum of £150 million. The charge would be triggered in the event that the Group defaults on agreed contributions due to the Fund or if an insolvency event occurs with respect to the UK entity responsible for making the payments. The charge is due to be released in 2039 but may be released earlier by negotiation or if the assets of the Fund are sufficient to achieve certain funding levels. Under the rules of the scheme, any future surplus would be returnable to the Group by refund at the end of the life of the scheme. The funding commitment is therefore not considered onerous and in accordance with IFRIC 14 no additional liabilities have been recognised in respect of this commitment.

Payments made to pensioners by the operating companies in Germany, net of income on scheme assets, are deemed to be company contributions to the Contractual Trust Arrangements and are anticipated to be around £27 million per annum for the next five years. Contributions to pension schemes in Canada, the Netherlands and Switzerland in total are anticipated to be around £22 million per annum for the next five years. Group contributions to pension schemes in 2015 are expected to be £243 million in total compared to £241 million in 2014.

The majority of benefit payments are from trustee administered funds; however, there are also a number of unfunded schemes where the sponsoring company meets the benefit payment obligation as it falls due. For unfunded schemes in the UK and Canada, 32% of the liabilities reported at year-end are expected to be settled by the Group within 10 years, 29% between 10 and 20 years, 20% between 20 and 30 years, and 19% thereafter.

The funded arrangements in the Group have policies on investment management, including strategies over a preferred long-term investment profile, and schemes in certain territories including Canada and the Netherlands manage their bond portfolios to match the weighted average duration of scheme liabilities. In addition, the main scheme in the UK has a target investment strategy such that, by 31 December 2018, the scheme will have moved to 20% return-seeking assets and 80% risk-reducing assets. Investments are diversified by type of investment, by investment sector, and where appropriate by country.

Through its defined benefit pension schemes and health care schemes, the Group is exposed to a number of risks, including:

Asset volatility

The plan liabilities are calculated using discount rates set by reference to bond yields; if plan assets underperform this yield e.g. due to stock market volatility, this will create a deficit. However, most schemes hold a proportion of assets which are expected to outperform bonds in the long term, and the majority of schemes by value are subject to local regulation regarding funding deficits.

Changes in bond yields

A decrease in corporate bond yields will increase scheme liabilities, although this will be partially offset by an increase in the value of the schemes' bond holdings or other hedging instruments.

Inflation risk

Some of the Group's pension obligations are linked to inflation and higher inflation will lead to higher liabilities, although, in most cases, caps on the level of inflationary increases are in place in the scheme rules, while some assets and derivatives provide specific inflation protection.

Life expectancy

The majority of the schemes' obligations are to provide benefits for the life of the member, so increases in life expectancy will result in an increase in the plans' liabilities. Assumptions regarding mortality and mortality improvements are regularly reviewed in line with actuarial tables and scheme specific experience.

The amounts recognised in the Balance Sheet are determined as follows:

	Pension schemes		**Health care schemes**		**Total**	
	2014	**2013**	**2014**	**2013**	**2014**	**2013**
	£m	**£m**	**£m**	**£m**	**£m**	**£m**
Present value of funded scheme liabilities	**(6,594)**	(5,905)	**(15)**	(16)	**(6,609)**	(5,921)
Fair value of funded scheme assets	**6,253**	5,767	**13**	13	**6,266**	5,780
	(341)	(138)	**(2)**	(3)	**(343)**	(141)
Unrecognised funded scheme surpluses	**(13)**	(19)	**—**	—	**(13)**	(19)
	(354)	(157)	**(2)**	(3)	**(356)**	(160)
Present value of unfunded scheme liabilities	**(287)**	(239)	**(98)**	(98)	**(385)**	(337)
	(641)	(396)	**(100)**	(101)	**(741)**	(497)
The above net liability is recognised in the Balance Sheet as follows:						
- retirement benefit scheme liabilities	**(681)**	(531)	**(100)**	(101)	**(781)**	(632)
- retirement benefit scheme assets	**40**	135	**—**	—	**40**	135
	(641)	(396)	**(100)**	(101)	**(741)**	(497)

The net liabilities of funded pension schemes by territory are as follows:

	Liabilities		**Assets**		**Total**	
	2014	**2013**	**2014**	**2013**	**2014**	**2013**
	£m	**£m**	**£m**	**£m**	**£m**	**£m**
- UK	**(3,217)**	(2,863)	**3,198**	2,771	**(19)**	(92)
- Germany	**(929)**	(831)	**733**	762	**(196)**	(69)
- Canada	**(753)**	(704)	**762**	745	**9**	41
- Netherlands	**(704)**	(560)	**685**	633	**(19)**	73
- Switzerland	**(349)**	(348)	**272**	286	**(77)**	(62)
- Rest of Group	**(642)**	(599)	**603**	570	**(39)**	(29)
Funded schemes	**(6,594)**	(5,905)	**6,253**	5,767	**(341)**	(138)

Of the Group's unfunded pension schemes 57% (2013: 53%) relate to arrangements in the UK, while 81% (2013: 82%) of the Group's unfunded health care arrangements relate to arrangements in Canada.

The amounts recognised in the Income Statement are as follows:

	Pension schemes		Health care schemes		Total	
	2014	**2013**	**2014**	**2013**	**2014**	**2013**
	£m	**£m**	**£m**	**£m**	**£m**	**£m**
Defined benefit schemes						
Service cost						
- current service cost	**81**	92	**1**	1	**82**	93
- past service cost	**(2)**	5	**(3)**	(5)	**(5)**	—
Net interest on the net defined benefit liability						
- interest on scheme liabilities	**261**	253	**6**	7	**267**	260
- interest on scheme assets	**(252)**	(227)	**(1)**	(1)	**(253)**	(228)
- interest on unrecognised funded scheme surpluses	**1**	1	**—**	—	**1**	1
	89	124	**3**	2	**92**	126
Defined contribution schemes	**40**	36	**—**	—	**40**	36
Total amount recognised in the Income Statement (note 3(a))	**129**	160	**3**	2	**132**	162

The above charges are recognised within employee benefit costs in note 3(a) and include a charge of £4 million in 2014 (2013: £7 million charge) in respect of settlements, past service costs and defined contribution costs reported as part of the restructuring costs charged in arriving at profit from operations (see note 3(e)).

The amounts recognised in other comprehensive income in respect of actuarial gains and losses of subsidiaries are as follows:

	Pension schemes		Healthcare schemes		Total	
	2014	**2013**	**2014**	**2013**	**2014**	**2013**
	£m	**£m**	**£m**	**£m**	**£m**	**£m**
Actuarial (losses)/gains on scheme liabilities	**(878)**	139	**(6)**	42	**(884)**	181
Actuarial gains on scheme assets	**456**	127	**—**	—	**456**	127
Net actuarial (losses)/gains in other comprehensive income (note 20)	**(422)**	266	**(6)**	42	**(428)**	308

The amounts recognised in other comprehensive income in respect of surplus restrictions of subsidiaries are as follows:

	Pension schemes		Healthcare schemes		Total	
	2014	**2013**	**2014**	**2013**	**2014**	**2013**
	£m	**£m**	**£m**	**£m**	**£m**	**£m**
Movements in the year (note 20)	**7**	(5)	**—**	—	**7**	(5)

The movements in scheme liabilities are as follows:

	Pension schemes		Health care schemes		Total	
	2014	**2013**	**2014**	**2013**	**2014**	**2013**
	£m	**£m**	**£m**	**£m**	**£m**	**£m**
Present value at 1 January	**6,144**	6,420	**114**	175	**6,258**	6,595
Differences on exchange	**(142)**	(106)	**(4)**	(15)	**(146)**	(121)
Current service cost	**80**	91	**1**	1	**81**	92
Past service cost	**(2)**	5	**(3)**	(5)	**(5)**	—
Settlements	**—**	(46)	**—**	—	**—**	(46)
Interest on scheme liabilities	**258**	244	**6**	7	**264**	251
Contributions by scheme members	**4**	2	**—**	—	**4**	2
Benefits paid	**(339)**	(327)	**(7)**	(7)	**(346)**	(334)
Actuarial losses/(gains)	**878**	(139)	**6**	(42)	**884**	(181)
Present value at 31 December	**6,881**	6,144	**113**	114	**6,994**	6,258
Scheme liabilities by scheme membership:						
Active members	**1,354**	1,279	**23**	20	**1,377**	1,299
Deferred members	**1,080**	912	**8**	11	**1,088**	923
Retired members	**4,447**	3,953	**82**	83	**4,529**	4,036
Present value at 31 December	**6,881**	6,144	**113**	114	**6,994**	6,258

Approximately 95% of scheme liabilities in both years relate to guaranteed benefits.

Actuarial losses/(gains) shown above can be analysed as follows:

	Pension schemes		Health care schemes		Total	
	2014	**2013**	**2014**	**2013**	**2014**	**2013**
	£m	**£m**	**£m**	**£m**	**£m**	**£m**
Actuarial losses/(gains):						
- arising from changes in demographic assumptions	**120**	26	**3**	(1)	**123**	25
- arising from changes in financial assumptions	**766**	(143)	**6**	(40)	**772**	(183)
Experience gains	**(8)**	(22)	**(3)**	(1)	**(11)**	(23)
Total	**878**	(139)	**6**	(42)	**884**	(181)

Changes in financial assumptions principally relate to discount rate and inflation rate movements.

The movements in funded scheme assets are as follows:

	Pension schemes		Health care schemes		Total	
	2014	**2013**	**2014**	**2013**	**2014**	**2013**
	£m	**£m**	**£m**	**£m**	**£m**	**£m**
Fair value of scheme assets at 1 January	**5,767**	5,547	**13**	16	**5,780**	5,563
Differences on exchange	**(141)**	(93)	**(1)**	(3)	**(142)**	(96)
Settlements	**—**	(46)	**—**	—	**—**	(46)
Interest on scheme assets	**249**	219	**1**	1	**250**	220
Company contributions net of reimbursements	**241**	320	**—**	—	**241**	320
Contributions by scheme members	**4**	4	**—**	—	**4**	4
Benefits paid	**(323)**	(311)	**—**	(1)	**(323)**	(312)
Actuarial gains	**456**	127	**—**	—	**456**	127
Fair value of scheme assets at 31 December	**6,253**	5,767	**13**	13	**6,266**	5,780

Company contributions for 2014 in the table above are shown net of a reimbursement of £1 million from a Jamaican pension scheme in the course of being wound up (2013: £7 million).

Fair value of scheme assets by category:

	Pension schemes		Health care schemes		Total	
	2014	2013	2014	2013	2014	2013
	£m	£m	£m	£m	£m	£m
Equities — listed	**1,759**	1,908	**5**	5	**1,764**	1,913
Equities — unlisted	**533**	513	**—**	—	**533**	513
Bonds — listed	**2,812**	2,647	**4**	8	**2,816**	2,655
Bonds — unlisted	**34**	151	**—**	—	**34**	151
Other assets — listed	**84**	137	**4**	—	**88**	137
Other assets — unlisted	**1,031**	411	**—**	—	**1,031**	411
Fair value of scheme assets at 31 December	**6,253**	5,767	**13**	13	**6,266**	5,780

Scheme assets have been diversified into equities, bonds and other assets and are typically invested via fund investment managers into both pooled and segregated mandates of listed and unlisted equities and bonds. In addition certain scheme assets, including a portion of the assets held in the main UK pension scheme, are further diversified by investing in equities listed on foreign stock exchanges via investment funds. In the above analysis investments via equity-based investment funds are shown under listed equities, and investments via bond-based investment funds are shown under listed bonds.

In Jamaica, a pension scheme holds shares in Carreras Group Ltd. (a Group subsidiary) with a fair value of £1 million (2013: £1 million). The shares are listed on the Jamaica Stock Exchange.

Other assets include cash and other deposits, derivatives and other hedges (including liability driven investments funds and inflation opportunity funds), recoverable taxes, reinsurance contracts, infrastructure investments and investment property.

The actuarial gains and losses in both years principally relate to movements in the fair values of scheme assets and actual returns are stated net of applicable taxes and fund management fees.

	Pension schemes		Health care schemes		Total	
	2014	2013	2014	2013	2014	2013
	£m	£m	£m	£m	£m	£m
Actual return on scheme assets	**705**	346	**1**	1	**706**	347

The movements in the unrecognised scheme surpluses, recognised in other comprehensive income, are as follows:

	Pension schemes		Health care schemes		Total	
	2014	2013	2014	2013	2014	2013
	£m	£m	£m	£m	£m	£m
Unrecognised funded scheme surpluses at 1 January	**(19)**	(15)	**—**	—	**(19)**	(15)
Differences on exchange	**—**	2	**—**	—	**—**	2
Interest on unrecognised funded scheme surpluses	**(1)**	(1)	**—**	—	**(1)**	(1)
Movement in year (note 20)	**7**	(5)	**—**	—	**7**	(5)
Unrecognised funded scheme surpluses at 31 December	**(13)**	(19)	**—**	—	**(13)**	(19)

The principal actuarial assumptions (weighted to reflect individual scheme differences) used in the following principal countries are shown below. In both years, discount rates are determined by reference to normal yields on high-quality corporate bonds at the balance sheet date. For countries where there is not a deep market in such corporate bonds, the yield on government bonds is used.

	UK	Germany	Canada	Netherlands	Switzerland
	%	%	%	%	%
31 December 2014					
Rate of increase in salaries	**4.5**	**2.5**	**3.3**	**2.0**	**1.5**
Rate of increase in pensions in payment	**3.0**	**1.8**	**Nil**	**1.6**	**Nil**
Rate of increase in deferred pensions	**2.5**	**Nil**	**Nil**	**1.6**	**—**
Discount rate	**3.4**	**1.9**	**3.8**	**2.0**	**1.1**
General inflation	**3.0**	**1.8**	**2.3**	**2.0**	**Nil**

	UK years	Germany years	Canada years	Netherlands years	Switzerland years
31 December 2014					
Weighted average duration of liabilities	**17.2**	**14.0**	**11.2**	**19.4**	**14.8**

For health care inflation in Canada, the assumption is 4.0%. For the remaining pension schemes, typical assumptions are that real salary increases will be from 0% to 4.5% per annum and discount rates will be from 0% to 5.9% above inflation. Pension increases, where allowed for, are generally assumed to be in line with inflation.

	UK %	Germany %	Canada %	Netherlands %	Switzerland %
31 December 2013					
Rate of increase in salaries	4.9	2.5	3.3	2.7	1.5
Rate of increase in pensions in payment	3.4	1.8	Nil	1.5	Nil
Rate of increase in deferred pensions	2.9	Nil	Nil	1.5	—
Discount rate	4.4	3.4	4.6	3.7	2.3
General inflation	3.4	1.8	2.3	1.5	Nil

	UK years	Germany years	Canada years	Netherlands years	Switzerland years
31 December 2013					
Weighted average duration of liabilities	16.6	11.2	11.1	16.0	15.6

For health care inflation in Canada, the assumption was 4.35% increasing to 5.0% by 2018. For the remaining pension schemes, typical assumptions were that real salary increases would be from 0.5% to 3.1% per annum and discount rates would be from 0.5% to 6.8% above inflation. Pension increases, where allowed for, were generally assumed to be in line with inflation.

Mortality assumptions are subject to regular review. The principal schemes used the following tables:

UK	2014:	91.5% S1NA (year of birth) table with the Continuous Mortality Investigation (2013) model with a 1.75% long-term improvement rate
	2013:	S1NA (year of birth) table with the Continuous Mortality Investigation (2009) model with a 1.5% long-term improvement rate
Germany		Heubeck tables 2005G (both years)
Canada	2014:	CPM-2014 Private Table
	2013:	UP94 tables
Netherlands	2014:	AG Prognosetafel 2014
	2013:	AG Prognosetafel 2012–2062 tables
Switzerland		LPP 2010 tables (both years)

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 2014										
Member age 65 (current life expectancy)	**23.6**	**26.1**	**18.9**	**23.0**	**20.8**	**23.3**	**20.8**	**24.7**	**21.4**	**23.9**
Member age 45 (life expectancy at age 65)	**26.3**	**28.9**	**21.6**	**25.5**	**22.0**	**24.3**	**23.3**	**26.7**	**23.2**	**25.6**
31 December 2013										
Member age 65 (current life expectancy)	22.8	25.0	18.8	22.8	19.8	22.1	20.4	24.8	21.3	23.8
Member age 45 (life expectancy at age 65)	25.1	27.4	21.4	25.4	21.3	22.9	22.4	25.7	23.1	25.5

Valuation of retirement benefit schemes involves judgements about uncertain future events. Sensitivities in respect of the key assumptions used to measure the principal pension schemes as at 31 December 2014 are set out below. These sensitivities show the hypothetical impact of a change in each of the listed assumptions in isolation, with the exception of the sensitivity to inflation which incorporates the impact of certain correlating assumptions such as salary increases. While each of these sensitivities holds all other assumptions constant, in practice such assumptions rarely change in isolation, while asset values also change, and the impacts may offset to some extent.

	1 year increase	1 year decrease	0.25 percentage point increase	0.25 percentage point decrease
	£m	£m	£m	£m
Average life expectancy — increase/(decrease) of scheme liabilities	**187**	**(186)**		
Rate of inflation — increase/(decrease) of scheme liabilities			**216**	**(204)**
Discount rate — (decrease)/increase of scheme liabilities			**(163)**	**177**

A one percentage point increase in health care inflation would increase health care scheme liabilities by £13 million, and a one percentage point decrease would decrease liabilities by £10 million. The Income Statement effect of this change in assumption is not material.

13 Deferred tax

Deferred tax assets comprise:

	Stock relief	Excess of depreciation over capital allowances	Tax losses	Retirement benefits	Fair value losses/ (gains)	Other temporary differences	Total
	£m	£m	£m	£m	£m	£m	£m
At 1 January 2014	**46**	**34**	**67**	**104**	**—**	**157**	**408**
Differences on exchange	**(5)**	**(2)**	**(4)**	**(7)**	**—**	**(5)**	**(23)**
(Charged)/credited to the Income Statement	**(10)**	**2**	**(17)**	**(7)**	**62**	**(14)**	**16**
Credited to other comprehensive income	**—**	**—**	**—**	**65**	**—**	**—**	**65**
At 31 December 2014	**31**	**34**	**46**	**155**	**62**	**138**	**466**
At 1 January 2013	65	37	36	170	4	191	503
Differences on exchange	(7)	(1)	(5)	(5)	—	(15)	(33)
Credited/(charged) to the Income Statement	(12)	(2)	36	(2)	(1)	(19)	—
Charged to other comprehensive income	—	—	—	(59)	(3)	—	(62)
At 31 December 2013	46	34	67	104	—	157	408

Deferred tax liabilities comprise:

	Stock relief	Excess of capital allowances over depreciation	Undistributed earnings of associates and subsidiaries	Retirement benefits	Fair value (losses)/ gains	Other temporary differences	Total
	£m	£m	£m	£m	£m	£m	£m
At 1 January 2014	**11**	**164**	**181**	**105**	**37**	**176**	**674**
Differences on exchange	**2**	**(5)**	**6**	**(8)**	**—**	**(11)**	**(16)**
(Credited)/charged to the Income Statement	**(5)**	**17**	**12**	**2**	**—**	**(5)**	**21**
Charged/(credited) to other comprehensive income	**—**	**—**	**5**	**(23)**	**(14)**	**3**	**(29)**
At 31 December 2014	**8**	**176**	**204**	**76**	**23**	**163**	**650**
At 1 January 2013	16	182	168	119	24	167	676
Differences on exchange	1	(13)	(13)	2	—	(3)	(26)
(Credited)/charged to the Income Statement	(6)	(5)	26	5	1	12	33
(Credited)/charged to other comprehensive income	—	—	—	(21)	12	—	(9)
At 31 December 2013	11	164	181	105	37	176	674

	2014	2013
	£m	£m
Net deferred tax liabilities	**184**	266

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.

	2014	2013
	£m	£m
Deferred tax assets	**(311)**	(248)
Deferred tax liabilities	**495**	514
	184	266

Deferred tax expected to be recovered within 12 months:

	2014	2013
	£m	£m
Deferred tax assets	**(112)**	(115)
Deferred tax liabilities	**364**	300
	252	185

At the balance sheet date, the Group has unused tax losses of £704 million (2013: £598 million) which have no expiry date and unused tax losses of £642 million (2013: £558 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 £971 million (2013: £1,005 million), which have no expiry date and £193 million (2013: £159 million), which will expire within the next 10 years.

At the balance sheet date, the Group has unused tax credits of £80 million (2013: £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 (2013: £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

	2014	2013
	£m	£m
Trade receivables	**2,071**	2,208
Loans and other receivables	**697**	692
Prepayments and accrued income	**153**	147
	2,921	3,047
Current	**2,768**	2,876
Non-current	**153**	171
	2,921	3,047

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:

	2014	2013
	£m	£m
Gross trade and other receivables	**2,975**	3,103
Allowance account	**(54)**	(56)
Net trade and other receivables per Balance Sheet	**2,921**	3,047

The movements in the allowance account are as follows:

	2014	2013
	£m	£m
1 January	**56**	52
Differences on exchange	**(3)**	(3)
Provided in the year	**11**	10
Amounts reversed during the year	**(10)**	(3)
31 December	**54**	56

Impairment of trade receivables, including write-offs and allowances, charged during the year is included as part of other operating expenses. For 2014, the net impairment charge was £4 million (2013: £9 million) of which £1 million (2013: £7 million), is reflected in the above table.

As at 31 December 2014, trade and other receivables of £39 million (2013: £46 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:

	2014	2013
	£m	£m
Less than three months	**31**	34
Between three and six months	**2**	4
Between six months and one year	**3**	3
Greater than one year	**3**	5

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:

	2014	2013
	£m	£m
US dollar	**141**	107
UK sterling	**195**	131
Euro	**62**	31
Other currencies	**185**	172

Trade and other receivables also include certain interest bearing amounts and their effective interest rates are as follows:

	2014	2013	2014	2013
	£m	£m	%	%
UK sterling	**5**	5	**10.0**	10.0
Euro	**3**	5	**4.0**	4.0
Other currencies	**2**	3	**5.5**	5.1

There is no material difference between the above amounts for trade and other receivables and their fair value due to the short-term duration of the majority of trade and other receivables as determined using discounted cash flow analysis. There is no concentration of credit risk with respect to trade receivables as the Group has a large number of internationally dispersed customers.

15 Available-for-sale investments

	2014 £m	2013 £m
1 January	**90**	63
Differences on exchange	**(4)**	1
Additions and advances	**32**	46
Disposals and repayments	**(32)**	(20)
31 December	**86**	90
Current	**50**	54
Non-current	**36**	36
	86	90

The classification of these investments under the IFRS 13 fair value hierarchy is given in note 24.

Investments have the following maturities:

	As per Balance Sheet	
	2014 £m	2013 £m
Equity investments	**36**	36
Non-equity investments		
- within one year	**49**	53
- beyond two years and within three years	**1**	—
- beyond three years and within four years	**—**	1
	86	90

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.

Included within non-equity investments are cash deposits of £32 million (2013: £nil) which do not meet the definition of cash and cash equivalents.

Investments are all denominated in the functional currency of the subsidiary undertaking holding the investments.

16 Derivative financial instruments

The fair values of derivatives are determined based on market data (primarily yield curves, implied volatilities and exchange rates) to calculate the present value of all estimated flows associated with each derivative at the balance sheet date. In the absence of sufficient market data, fair values would be based on the quoted market price of similar derivatives. The classification of these derivative assets and liabilities under the IFRS 13 fair value hierarchy is given in note 24.

	2014		2013	
	Assets	Liabilities	Assets	Liabilities
	£m	£m	£m	£m
Fair value hedges				
- interest rate swaps	**300**	**102**	121	63
- cross-currency swaps	**6**	**18**	6	38
Cash flow hedges				
- cross-currency swaps	**30**	**5**	—	3
- forward foreign currency contracts	**139**	**38**	106	25
Net investment hedges				
- forward foreign currency contracts	**55**	**52**	161	5
Held-for-trading *				
- forward foreign currency contracts	**31**	**34**	31	30
Total	**561**	**249**	425	164
Current	**274**	**126**	312	34
Non-current	**287**	**123**	113	130
	561	**249**	425	164
Derivatives				
- in respect of net debt	**362**	**137**	146	125
- other	**199**	**112**	279	39
	561	**249**	425	164

* As explained in note 4, some derivative financial instruments are not designated as hedges and so are required to be classified as held-for-trading.

For cash flow hedges, the timing of expected cash flows is as follows:

	2014		2013	
	Assets	Liabilities	Assets	Liabilities
	£m	£m	£m	£m
Within one year	**150**	**38**	92	27
Between one and two years	**17**	**5**	14	1
Between two and three years	**2**	**—**	—	—
	169	**43**	106	28

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.

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:

	2014				2013			
	Assets		Liabilities		Assets		Liabilities	
	Inflow	Outflow	Inflow	Outflow	Inflow	Outflow	Inflow	Outflow
	£m	£m	£m	£m	£m	£m	£m	£m
Within one year								
- forward foreign currency contracts	**4,993**	**(4,803)**	**2,960**	**(2,935)**	5,681	(5,405)	2,949	(3,006)
- cross-currency swaps	**186**	**(149)**	**18**	**(4)**	4	(2)	195	(182)
Between one and two years								
- forward foreign currency contracts	**398**	**(377)**	**112**	**(115)**	276	(260)	63	(64)
- cross-currency swaps	**19**	**(16)**	**343**	**(370)**	4	(2)	33	(16)
Between two and three years								
- forward foreign currency contracts	**49**	**(46)**	**—**	**—**	—	—	—	—
- cross-currency swaps	**19**	**(20)**	**—**	**—**	4	(3)	358	(415)
Between three and four years								
- cross-currency swaps	**19**	**(22)**	**—**	**—**	4	(4)	15	(19)
Between four and five years								
- cross-currency swaps	**34**	**(23)**	**—**	**(14)**	4	(4)	15	(21)
Beyond five years								
- cross-currency swaps	**709**	**(774)**	**—**	**—**	110	(100)	461	(513)
	6,426	**(6,230)**	**3,433**	**(3,438)**	6,087	(5,780)	4,089	(4,236)

The maturity dates of net-settled derivative financial instruments are as follows:

	2014		2013	
	Assets Inflow/ (Outflow)	Liabilities (Inflow)/ Outflow	Assets Inflow/ (Outflow)	Liabilities (Inflow)/ Outflow
	£m	£m	£m	£m
Within one year	**62**	**(61)**	50	(22)
Between one and two years	**59**	**25**	27	(14)
Between two and three years	**49**	**24**	10	1
Between three and four years	**41**	**10**	9	11
Between four and five years	**35**	**9**	9	12
Beyond five years	**55**	**30**	23	89
	301	**37**	128	77

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:

	2014		2013	
	Assets	Liabilities	Assets	Liabilities
	£m	£m	£m	£m
Interest rate swaps	**300**	**102**	121	63
Cross-currency swaps	**36**	**23**	6	41
Forward foreign currency contracts	**225**	**124**	298	60
	561	**249**	425	164

(a) Interest rate swaps

	2014							
					Interest rate %			
	Maturity date	Principal currency	m	£m	Original	Swapped	Assets £m	Liabilities £m
Fixed to floating	**2017**	**USD**	**600**	**385**	**2.1**	**note (a)**	**—**	**1**
	2019	**GBP**	**250**	**250**	**6.4**	**note (a)**	**47**	**—**
	2020	**EUR**	**600**	**466**	**4.0**	**note (a)**	**70**	**—**
	2020	**GBP**	**650**	**650**	**4.0**	**note (a)**	**27**	**—**
	2021	**EUR**	**600**	**466**	**3.1**	**note (a)**	**34**	**—**
	2022	**USD**	**900**	**577**	**3.3**	**note (a)**	**2**	**—**
	2023	**EUR**	**750**	**582**	**2.4**	**note (a)**	**60**	**—**
	2025	**EUR**	**650**	**504**	**2.8**	**note (a)**	**60**	**—**
Floating to fixed	**2017**	**EUR**	**600**	**466**	**note (a)**	**3.7**	**—**	**33**
	2023 *	**EUR**	**750**	**582**	**note (a)**	**2.8**	**—**	**68**
							300	**102**

	2013							
					Interest rate %			
	Maturity date	Principal currency	m	£m	Original	Swapped	Assets £m	Liabilities £m
Fixed to floating	2014	GBP	500	500	6.0	note (a)	13	—
	2014	GBP	250	250	6.0	note (a)	11	—
	2017	USD	600	362	2.1	note (a)	—	1
	2019	GBP	250	250	6.4	note (a)	43	—
	2020	EUR	600	499	4.0	note (a)	47	—
	2020	GBP	650	650	4.0	note (a)	—	8
	2023	EUR	750	624	2.4	note (a)	—	4
	2025	EUR	650	541	2.8	note (a)	—	15
Floating to fixed	2017	EUR	600	499	note (a)	3.7	—	35
	2023 *	EUR	750	624	note (a)	2.8	7	—
							121	63

* The €750 million euro interest rate swap maturing in 2023 has a start date of 2015.

Note (a): the floating rate interest rates are based on LIBOR (or local equivalent) plus a margin ranging between 67 and 176 basis points (2013: between 67 and 268 basis points).

These swaps have been used to manage the interest rate profile of external borrowings and are reflected in the repricing table in note 21.

(b) Cross-currency swaps

	2014										
	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**	**367**	**—**	**17**
	2019	**EUR**	**4.6**	**20**	**16**	**USD**	**note (b)**	**22**	**14**	**5**	**—**
	2021	**EUR**	**3.6**	**600**	**466**	**GBP**	**note (b)**	**518**	**518**	**1**	**—**
	2021	**CHF**	**0.6**	**320**	**207**	**GBP**	**note (b)**	**210**	**210**	**—**	**1**
Floating to fixed	**2015**	**BRL**	**note (b)**	**150**	**36**	**USD**	**1.0**	**68**	**44**	**—**	**5**
	2015	**USD**	**note (b)**	**261**	**167**	**COP**	**6.8**	**502,692**	**136**	**30**	**—**
										36	**23**

	2013										
	Maturity date	Original currency	Interest rate %	Principal original currency m	£m	Swapped currency	Interest rate %	Principal swapped currency m	£m	Assets £m	Liabilities £m
Fixed to floating . . .	2016	GBP	5.5	325	325	EUR	note (b)	473	394	—	37
	2019	EUR	4.6	20	17	USD	note (b)	22	12	6	—
	2021	EUR	3.6	600	499	GBP	note (b)	518	518	—	1
Floating to fixed . . .	2014	USD	note (b)	261	158	COP	7.2	504,158	158	—	3
										6	41

Note (b): the floating rate interest rates are based on LIBOR (or local equivalent) plus a margin ranging between 65 and 250 basis points (2013: between 82 and 250 basis points).

(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.

	2014		2013	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m
Purchase/Sell				
GBP/EUR	**32**	**—**	17	1
GBP/AUD	**18**	**—**	70	—
GBP/ZAR	**—**	**1**	19	—
GBP/CHF	**6**	**—**	5	1
GBP/USD	**—**	**49**	56	—
GBP/CAD	**2**	**1**	16	—
GBP/JPY	**22**	**—**	—	—
EUR/USD	**—**	**8**	5	—
USD/EUR	**38**	**—**	—	13
USD/GBP	**15**	**—**	—	14
USD/JPY	**43**	**—**	82	—
BRL/USD	**—**	**35**	—	2
Other	**49**	**30**	28	29
	225	**124**	298	60

Certain of these contracts were used to manage the currency profile of external borrowings and are reflected in the currency table in note 21. The nominal values of these contracts are as follows:

	2014		2013	
	Purchase £m	Sell £m	Purchase £m	Sell £m
Purchase/Sell				
GBP/CHF	**—**	**—**	(226)	225
GBP/CAD	**(204)**	**202**	(211)	207
GBP/USD	**(192)**	**192**	(187)	181
GBP/EUR	**(76)**	**75**	(125)	124
EUR/DKK	**(339)**	**339**	(313)	313
EUR/SEK	**(116)**	**114**	(129)	131
EUR/NOK	**(137)**	**128**	(150)	149
CHF/GBP	**(223)**	**228**	—	—

17 Inventories

	2014 £m	2013 £m
Raw materials and consumables	**1,732**	1,700
Finished goods and work in progress	**2,211**	2,144
Goods purchased for resale	**190**	198
	4,133	4,042

Inventories pledged as security for liabilities amount to £4 million (2013: £14 million). Write-offs taken to other operating expenses in the Group Income Statement comprise £47 million (2013: £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 2014 and 2013.

19 Cash and cash equivalents

	2014 £m	2013 £m
Cash and bank balances	**1,199**	1,399
Cash equivalents	**619**	707
	1,818	2,106

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:

	2014 £m	2013 £m
Functional currency	**1,559**	1,804
US dollar	**115**	104
UK sterling	**13**	57
Euro	**47**	54
Other currencies	**84**	87
	1,818	2,106

At 31 December 2014, cash and cash equivalents of £nil (2013: £3 million) were pledged as collateral.

In the Group Cash Flow Statement, net cash and cash equivalents are shown after deducting bank overdrafts and accrued interest where applicable, as follows:

	2014 £m	2013 £m
Cash and cash equivalents as above	**1,818**	2,106
Less accrued interest	**(1)**	(1)
Less overdrafts	**(325)**	(329)
Net cash and cash equivalents	**1,492**	1,776

Cash and cash equivalents include restricted amounts of £190 million (2013: £158 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						
	Share capital	Share premium, capital redemption and merger reserves	Other reserves	Retained earnings	Total attributable to owners of the parent	Non-controlling interests	Total equity
	£m	£m	£m	£m	£m	£m	£m
1 January 2014	**507**	**3,919**	**(190)**	**2,398**	**6,634**	**301**	**6,935**
Comprehensive income and expense							
Profit for the year	—	—	—	3,115	3,115	278	3,393
Differences on exchange							
- subsidiaries	—	—	(526)	—	(526)	(13)	(539)
- associates	—	—	113	—	113	—	113
Cash flow hedges							
- net fair value gains	—	—	75	—	75	(18)	57
- reclassified and reported in profit for the year	—	—	(76)	—	(76)	9	(67)
- reclassified and reported in net assets	—	—	8	—	8	—	8
Available-for-sale investments of associates							
- net fair value gains	—	—	15	—	15	—	15
Net investment hedges							
- net fair value gains	—	—	2	—	2	—	2
- differences on exchange on borrowings	—	—	60	—	60	—	60
Tax on items recognised directly in other comprehensive income that may be reclassified subsequently to profit or loss (note 6(e))	—	—	21	—	21	3	24
Retirement benefit schemes							
- net actuarial losses in respect of subsidiaries (note 12)	—	—	—	(428)	(428)	—	(428)
- surplus recognition and minimum funding obligations in respect of subsidiaries (note 12)	—	—	—	7	7	—	7
- actuarial losses in respect of associates net of tax (note 5)	—	—	—	(124)	(124)	—	(124)
Tax on items recognised directly in other comprehensive income that will not be reclassified subsequently to profit or loss (note 6(e))	—	—	—	87	87	—	87
Other changes in equity							
Employee share options							
- value of employee services	—	—	—	66	66	—	66
- proceeds from shares issued	—	4	—	1	5	—	5
Dividends and other appropriations							
- ordinary shares	—	—	—	(2,712)	(2,712)	—	(2,712)
- to non-controlling interests	—	—	—	—	—	(260)	(260)
Purchase of own shares							
- held in employee share ownership trusts	—	—	—	(49)	(49)	—	(49)
- share buy-back programme	—	—	—	(800)	(800)	—	(800)
Non-controlling interests — acquisitions (note 29)	—	—	—	(4)	(4)	—	(4)
Non-controlling interests — capital injection (note 26(c))	—	—	—	—	—	4	4
Other movements	—	—	—	21	21	—	21
31 December 2014	**507**	**3,923**	**(498)**	**1,578**	**5,510**	**304**	**5,814**

	Attributable to owners of the parent						
	Share capital	Share premium, capital redemption and merger reserves	Other reserves	Retained earnings	Total attributable to owners of the parent	Non-controlling interests	Total equity
	£m	£m	£m	£m	£m	£m	£m
1 January 2013	507	3,916	796	2,253	7,472	307	7,779
Comprehensive income and expense							
Profit for the year	—	—	—	3,904	3,904	295	4,199
Differences on exchange							
- subsidiaries	—	—	(935)	—	(935)	(37)	(972)
- associates	—	—	(141)	—	(141)	—	(141)
Cash flow hedges							
- net fair value gains	—	—	103	—	103	(9)	94
- reclassified and reported in profit for the year	—	—	(56)	—	(56)	7	(49)
- reclassified and reported in net assets	—	—	(1)	—	(1)	—	(1)
Available-for-sale investments of associates							
- net fair value losses	—	—	(7)	—	(7)	—	(7)
Net investment hedges							
- net fair value gains	—	—	89	—	89	—	89
- differences on exchange on borrowings	—	—	(25)	—	(25)	—	(25)
Tax on items recognised directly in other comprehensive income that may be reclassified subsequently to profit or loss (note 6(e))	—	—	(13)	—	(13)	—	(13)
Retirement benefit schemes							
- net actuarial gains in respect of subsidiaries (note 12)	—	—	—	309	309	(1)	308
- surplus recognition and minimum funding obligations in respect of subsidiaries (note 12)	—	—	—	(6)	(6)	1	(5)
- actuarial gains in respect of associates net of tax (note 5)	—	—	—	90	90	—	90
Tax on items recognised directly in other comprehensive income that will not be reclassified subsequently to profit or loss (note 6(e))	—	—	—	(39)	(39)	1	(38)
Other changes in equity							
Employee share options							
- value of employee services	—	—	—	61	61	—	61
- proceeds from shares issued	—	3	—	1	4	—	4
Dividends and other appropriations							
- ordinary shares	—	—	—	(2,611)	(2,611)	—	(2,611)
- to non-controlling interests	—	—	—	—	—	(271)	(271)
Purchase of own shares							
- held in employee share ownership trusts	—	—	—	(74)	(74)	—	(74)
- share buy-back programme	—	—	—	(1,509)	(1,509)	—	(1,509)
Non-controlling interests — capital injection (note 26(b))	—	—	—	—	—	8	8
Other movements	—	—	—	19	19	—	19
31 December 2013	507	3,919	(190)	2,398	6,634	301	6,935

Details relating to the allotted share capital, and movements therein, are included in note 4 of the Parent Company financial statements.

(a) Share premium account, capital redemption reserves and merger reserves comprise:

	Share premium account	Capital redemption reserves	Merger reserves	Total
	£m	£m	£m	£m
1 January 2013	67	101	3,748	3,916
31 December 2013	70	101	3,748	3,919
31 December 2014	**74**	**101**	**3,748**	**3,923**

The share premium account includes the difference between the value of shares issued and their nominal value. The increase of £4 million (2013: £3 million) relates solely to ordinary shares issued under the Company's share option schemes. These schemes are described in the Remuneration Report.

On the purchase of own shares as part of the share buy-back programme for shares which are cancelled, a transfer is made from retained earnings to the capital redemption reserve equivalent to the nominal value of shares purchased. Purchased shares which are not cancelled are classified as treasury shares and presented as a deduction from total equity.

Total equity attributable to owners of the parent is stated after deducting the cost of treasury shares which include £4,845 million

(2013: £4,045 million) for shares repurchased and not cancelled and £228 million (2013: £280 million) in respect of the cost of own shares held in employee share ownership trusts.

During 2014, 23 million shares were bought back at a cost of £795 million (2013: 44 million shares at a cost of £1,500 million) excluding transaction costs of £5 million (2013: £9 million). The share buy-back programme was suspended from 30 July 2014.

In 1999, shares were issued for the acquisition of the Rothmans International B.V. Group, and the difference between the fair value of shares issued and their nominal value was credited to merger reserves.

(b) Information on the principal components of non-controlling interests is provided in note 31.

Movements in other reserves and retained earnings (which are after deducting treasury shares) shown above comprise:

	Translation reserve	Hedging reserve	Available-for-sale reserve	Revaluation reserve	Other	Total other reserves	Retained earnings Treasury shares	Retained earnings Other
	£m	£m	£m	£m	£m	£m	£m	£m
1 January 2014	**(1,015)**	**44**	**29**	**179**	**573**	**(190)**	**(4,325)**	**6,723**
Comprehensive income and expense								
Profit for the year	—	—	—	—	—	—	—	3,115
Differences on exchange								
- subsidiaries	(526)	—	—	—	—	(526)	—	—
- associates	113	—	—	—	—	113	—	—
Cash flow hedges								
- net fair value gains	—	75	—	—	—	75	—	—
- reclassified and reported in profit for the year	—	(76)	—	—	—	(76)	—	—
- reclassified and reported in net assets	—	8	—	—	—	8	—	—
Available-for-sale investments of associates								
- net fair value gains	—	—	15	—	—	15	—	—
Net investment hedges								
- net fair value gains	2	—	—	—	—	2	—	—
- differences on exchange on borrowings	60	—	—	—	—	60	—	—
Tax on items recognised directly in other comprehensive income that may be reclassified subsequently to profit or loss	(3)	24	—	—	—	21	—	—
Retirement benefit schemes								
- net actuarial losses in respect of subsidiaries (note 12)	—	—	—	—	—	—	—	(428)
- surplus recognition and minimum funding obligations in respect of subsidiaries (note 12)	—	—	—	—	—	—	—	7
- actuarial losses in respect of associates net of tax (note 5)	—	—	—	—	—	—	—	(124)
Tax on items recognised directly in other comprehensive income that will not be reclassified subsequently to profit or loss	—	—	—	—	—	—	—	87
Other changes in equity								
Employee share options								
- value of employee services	—	—	—	—	—	—	—	66
- proceeds from shares issued	—	—	—	—	—	—	1	—
Dividends and other appropriations								
- ordinary shares	—	—	—	—	—	—	—	(2,712)
Purchase of own shares								
- held in employee share ownership trusts	—	—	—	—	—	—	(49)	—
- share buy-back programme	—	—	—	—	—	—	(800)	—
Non-controlling interests — acquisitions (note 29)	—	—	—	—	—	—	—	(4)
Other movements	—	—	—	—	—	—	100	(79)
31 December 2014	**(1,369)**	**75**	**44**	**179**	**573**	**(498)**	**(5,073)**	**6,651**

British American Tobacco, p.l.c.

Notes on the Accounts (Continued)

	Translation reserve	Hedging reserve	Available-for-sale reserve	Revaluation reserve	Other	Total other reserves	Retained earnings	
							Treasury shares	Other
	£m	£m	£m	£m	£m	£m	£m	£m
1 January 2013	(3)	11	36	179	573	796	(2,824)	5,077
Comprehensive income and expense								
Profit for the year	—	—	—	—	—	—	—	3,904
Differences on exchange								
- subsidiaries	(935)	—	—	—	—	(935)	—	—
- associates	(141)	—	—	—	—	(141)	—	—
Cash flow hedges								
- net fair value gains	—	103	—	—	—	103	—	—
- reclassified and reported in profit for the year	—	(56)	—	—	—	(56)	—	—
- reclassified and reported in net assets	—	(1)	—	—	—	(1)	—	—
Available-for-sale investments of associates								
- net fair value losses	—	—	(7)	—	—	(7)	—	—
Net investment hedges								
- net fair value gains	89	—	—	—	—	89	—	—
- differences on exchange on borrowings	(25)	—	—	—	—	(25)	—	—
Tax on items recognised directly in other comprehensive income that may be reclassified subsequently to profit or loss	—	(13)	—	—	—	(13)	—	—
Retirement benefit schemes								
- net actuarial gains in respect of subsidiaries (note 12)	—	—	—	—	—	—	—	309
- surplus recognition and minimum funding obligations in respect of subsidiaries (note 12)	—	—	—	—	—	—	—	(6)
- actuarial gains in respect of associates net of tax (note 5)	—	—	—	—	—	—	—	90
Tax on items recognised directly in other comprehensive income that will not be reclassified subsequently to profit or loss	—	—	—	—	—	—	—	(39)
Other changes in equity								
Employee share options								
- value of employee services	—	—	—	—	—	—	—	61
- proceeds from shares issued	—	—	—	—	—	—	1	—
Dividends and other appropriations								
- ordinary shares	—	—	—	—	—	—	—	(2,611)
Purchase of own shares								
- held in employee share ownership trusts	—	—	—	—	—	—	(74)	—
- share buy-back programme	—	—	—	—	—	—	(1,509)	—
Other movements	—	—	—	—	—	—	81	(62)
31 December 2013	(1,015)	44	29	179	573	(190)	(4,325)	6,723

The translation reserve is as explained in the accounting policy on foreign currencies in note 1.

The hedging reserve and the available-for-sale reserve are as explained in the accounting policy on financial instruments in note 1.

The revaluation reserve relates to the acquisition of the cigarette and snus business of ST in 2008.

Of the amounts released from the hedging reserve during the year, gains of £21 million (2013: £28 million gain) and gains of £27 million (2013: £11 million gain) were reported within revenue and raw materials and consumables respectively, together with a loss of £13 million (2013: £3 million loss) reported in other operating expenses and a gain of £31 million (2013: £13 million gain) reported within net finance costs.

Other reserves comprise:

(a) £483 million which arose in 1998 from merger accounting in a Scheme of Arrangement and Reconstruction whereby British American Tobacco p.l.c. acquired the entire share capital of B.A.T Industries p.l.c. and the share capital of that company's principal financial services subsidiaries 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:

	2014 £m	2013 £m
Translation reserve		
Net investment hedges		
- difference on exchange on borrowings	(3)	—
	(3)	—
Hedging reserve		
Cash flow hedges		
- net fair value gains	(3)	(36)
- reclassified and reported in profit for the year	27	23
	24	(13)
Retained earnings		
- actuarial losses/(gains) in respect of subsidiaries	89	(41)
- surplus recognition and minimum funding obligations in respect of subsidiaries	(2)	2
	87	(39)
Owners of the parent	108	(52)
Non-controlling interests	3	1
Total tax recognised in other comprehensive income for the year (note 6(e))	111	(51)

21 Borrowings

	Currency	Maturity dates	Interest rates	2014 £m	2013 £m
Eurobonds	Euro	2015 to 2029	2.4% to 5.9%	5,211	5,372
	Euro	2018	3m EURIBOR + 50bps	309	—
	UK sterling	2016 to 2040	4.0% to 7.3%	3,083	3,118
	US dollar	2016	1.1%	192	182
	Swiss franc	2016	CHF 3m LIBOR + 16bps	226	—
	Swiss franc	2021 to 2026	0.7% to 1.4%	419	—
Bonds issued pursuant to Rule 144A and RegS under the US Securities Act (as amended)	US dollar	2015 to 2022	1.4% to 9.5%	1,726	1,620
Other notes	Malaysian ringgit	2014	4.1% to 4.5%	—	47
	Other currencies			—	24
Bonds and notes				11,166	10,363
Commercial paper				160	521
Other loans				223	136
Bank loans				374	341
Bank overdrafts				325	329
Finance leases				10	6
				12,258	11,696

The interest on the commercial paper referred to in the table above is based on USD LIBOR plus a margin ranging between 10 and 43 basis points (2013: 10 and 15 basis points).

	2014	2013
	£m	£m
Current	**2,479**	1,980
Non-current	**9,779**	9,716
	12,258	11,696

Current borrowings include interest payable of £240 million at 31 December 2014 (2013: £247 million). Included within borrowings are £4,522 million (2013: £4,466 million) of borrowings subject to fair value hedges where their amortised cost has been increased by £228 million (2013: £69 million) in the table above.

The fair value of borrowings is estimated to be £13,606 million (2013: £12,701 million). £12,533 million (2013: £11,873 million) has been calculated using quoted market prices and is within level 1 of the fair value hierarchy. £1,073 million (2013: £828 million) has been calculated based on discounted cash flow analysis and is within level 2 of the fair value hierarchy.

	2014	2013
	£m	£m
Amounts secured on Group assets	**14**	20

In both years amounts secured on Group assets include finance leases of £10 million (2013: £6 million) and amounts secured on certain inventory of the Group (see note 17).

Borrowings are repayable as follows:

	Per Balance Sheet		Contractual gross maturities	
	2014	2013	2014	2013
	£m	£m	£m	£m
Within one year	**2,479**	1,980	**2,656**	2,220
Between one and two years	**877**	1,343	**1,262**	1,798
Between two and three years	**1,349**	534	**1,756**	899
Between three and four years	**758**	1,513	**1,085**	1,790
Between four and five years	**560**	421	**799**	853
Beyond five years	**6,235**	5,905	**7,814**	7,732
	12,258	11,696	**15,372**	15,292

The contractual gross maturities in each year include the borrowings maturing in that year together with forecast interest payments on all borrowings which are outstanding for all or part of that year.

Borrowings are denominated in the functional currency of the subsidiary undertaking or other currencies as shown below:

	Functional currency	US dollar	UK sterling	Euro	Canadian dollar	Other currencies	Total
	£m	£m	£m	£m	£m	£m	£m
31 December 2014							
Total borrowings	**5,419**	**2,240**	**330**	**3,478**	**—**	**791**	**12,258**
Effect of derivative financial instruments							
- cross-currency swaps	**1,195**	**(109)**	**(325)**	**(482)**	**—**	**(207)**	**72**
- forward foreign currency contracts	**(244)**	**192**	**—**	**(517)**	**202**	**358**	**(9)**
	6,370	**2,323**	**5**	**2,479**	**202**	**942**	**12,321**
31 December 2013							
Total borrowings	5,643	2,353	329	3,248	—	123	11,696
Effect of derivative financial instruments							
- cross-currency swaps	1,070	(146)	(325)	(516)	—	—	83
- forward foreign currency contracts	(749)	181	—	(468)	207	818	(11)
	5,964	2,388	4	2,264	207	941	11,768

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	Between 1-2 years	Between 2-3 years	Between 3-4 years	Between 4-5 years	Beyond 5 years	Total
	£m	£m	£m	£m	£m	£m	£m
31 December 2014							
Total borrowings	**2,492**	**879**	**1,347**	**758**	**559**	**6,223**	**12,258**
Effect of derivative financial instruments							
- interest rate swaps	**2,832**	**—**	**81**	**—**	**(250)**	**(2,663)**	**—**
- cross-currency swaps	**1,086**	**(325)**	**—**	**—**	**(16)**	**(673)**	**72**
	6,410	**554**	**1,428**	**758**	**293**	**2,887**	**12,330**
31 December 2013							
Total borrowings	2,013	1,341	655	1,392	420	5,875	11,696
Effect of derivative financial instruments							
- interest rate swaps	2,427	(624)	—	137	—	(1,940)	—
- cross-currency swaps	924	—	(325)	—	—	(516)	83
	5,364	717	330	1,529	420	3,419	11,779

Details of the derivative financial instruments included in these tables are given in note 16.

Finance lease liabilities per the Balance Sheet and on a contractual gross maturity basis are payable as follows:

	2014	2013
	£m	£m
Within one year	**3**	2
Between one and two years	**2**	2
Between two and three years	**2**	1
Between three and four years	**1**	1
Between four and five years	**1**	—
Beyond five years	**1**	—
	10	6

There is no material difference between the repayable principal and the total gross cash flows shown above.

Borrowings facilities — undrawn committed facilities (see note 24) expire as follows:

	2014	2013
	£m	£m
Within one year	**3,165**	169
Between one and two years	**—**	2,000
Between two and three years	**96**	—
Between three and four years	**—**	91
Between four and five years	**3,000**	—
	6,261	2,260

The Group defines net debt as follows:

	2014	2013
	£m	£m
Borrowings (note 21)	**12,258**	11,696
Derivatives in respect of net debt:		
- assets (note 16)	**(362)**	(146)
- liabilities (note 16)	**137**	125
Cash and cash equivalents (note 19)	**(1,818)**	(2,106)
Current available-for-sale investments (note 15)	**(50)**	(54)
	10,165	9,515

22 Other provisions for liabilities and charges

	Restructuring of existing businesses	Employee related benefits	Fox River	Other provisions	Total
	£m	£m	£m	£m	£m
1 January 2014	**88**	**42**	**267**	**184**	**581**
Differences on exchange	**(4)**	**(1)**	**—**	**(7)**	**(12)**
Provided/(reversed) in respect of the year	**56**	**8**	**(27)**	**47**	**84**
Utilised during the year	**(36)**	**(9)**	**(63)**	**(57)**	**(165)**
31 December 2014	**104**	**40**	**177**	**167**	**488**
Analysed on the Balance Sheet as					
- current	**49**	**13**	**36**	**112**	**210**
- non-current	**55**	**27**	**141**	**55**	**278**
	104	**40**	**177**	**167**	**488**
1 January 2013	92	45	271	221	629
Differences on exchange	(4)	(4)	—	(26)	(34)
Provided in respect of the year	42	12	—	52	106
Utilised during the year	(42)	(11)	(4)	(63)	(120)
31 December 2013	88	42	267	184	581
Analysed on the Balance Sheet as					
- current	49	18	—	127	194
- non-current	39	24	267	57	387
	88	42	267	184	581

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 2014 and 2013 are as described in note 3(e). While some elements of the non-current provisions of £55 million will unwind over several years, as termination payments are made over extended periods in some countries, it is estimated that approximately 25% will unwind in 2016 and over 82% within five years.

Employee related benefits mainly relate to long-term employee benefits other than post-employment benefits. As the principal components of these provisions are long service awards and 'jubilee' payments due after a certain service period, they will unwind over several years. It is estimated that approximately 46% of the non-current provisions of £27 million will unwind within five years.

A provision of £274 million was made in 2011 for a potential claim under a 1998 settlement agreement entered into by a Group subsidiary in respect of the clean-up of sediment in the Fox River. On 30 September 2014, the Group, NCR, Appvion and Windward Prospects entered into the Funding Agreement. The details of this agreement are explained in note 30. This agreement led to payments of £56 million in the year. In addition, the Group incurred other costs of £7 million which were also charged against the provision. In light of the conclusion of the Funding Agreement, the sums that the Group has agreed to pay thereunder, as well as the available information in relation to the extent of the clean-up related costs, the Group has reviewed the Fox River provision and £27 million has been released from the provision in 2014. It is expected that the non-current provision will unwind within five years.

Other provisions comprise balances set up in the ordinary course of general business that cannot be classified within the other categories, such as sales returns, onerous contracts, 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 reversals of £18 million for restructuring of existing businesses, £nil for employee benefits and £17 million for other provisions.

23 Trade and other payables

	2014	2013
	£m	£m
Trade payables	**764**	814
Duty, excise and other taxes	**3,539**	3,642
Accrued charges and deferred income	**1,033**	1,038
Social security and other taxation	**7**	18
Sundry payables	**309**	360
	5,652	5,872
Current	**5,524**	5,741
Non-current	**128**	131
	5,652	5,872

Accrued charges and deferred income include £67 million of deferred income (2013: £87 million) and £6 million (2013: £3 million) in respect of interest payable. Deferred income relates primarily to government grants for property acquired in Brazil. Amounts payable to related parties including associated undertakings are shown in note 29.

There is no material difference between the above amounts for trade and other payables and their fair value due to the short-term duration of the majority of trade and other payables, as determined using discounted cash flow analysis.

Trade and other payables are predominantly denominated in the functional currencies of subsidiary undertakings with less than 5% in other currencies (2013: less than 5%).

24 Financial instruments and risk management

Management of financial risks

One of the principal responsibilities of Treasury is to manage the financial risks arising from the Group's underlying operations. Specifically Treasury manages, within an overall policy framework set by the Group's Main Board and Corporate Finance Committee (CFC), the Group's exposure to funding and liquidity, interest rate, foreign exchange and counterparty risks. The Group's treasury position is monitored by the CFC which meets regularly throughout the year and is chaired by the Group Finance Director. The approach is one of risk reduction within an overall framework of delivering total shareholder return.

The Group defines capital as net debt (see note 21) and equity (see note 20). The only externally imposed capital requirement for the Group is interest cover as described under interest rate risk below. The Group assesses its financial capacity by reference to cash flow, net debt and interest cover. Group policies include a set of financing principles and key performance indicators including the monitoring of credit ratings, interest cover and liquidity. These provide a framework within which the Group's capital base is managed and, in particular, the policies on dividends (as a percentage of long-term sustainable earnings) and share buy-back are decided. The key objective of the financing principles is to appropriately balance the interests of equity and debt holders in driving an efficient financing mix for the Group.

The Group manages its financial risks in line with the classification of its financial assets and liabilities in the Group's Balance Sheet and related notes.

The Group's management of specific risks is dealt with as follows:

Liquidity risk

It is the policy of the Group to maximise financial flexibility and minimise refinancing risk by issuing debt with a range of maturities, generally matching the projected cash flows of the Group and obtaining this financing from a wide range of providers. The Group has a target average centrally managed debt maturity of at least five years with no more than 20% of centrally managed debt maturing in a single rolling year. As at 31 December 2014, the average centrally managed debt maturity was 6.8 years (2013: 7.2 years) and the highest proportion of centrally managed debt maturing in a single rolling year was 18.7% (2013: 18.3%).

It is Group policy that short-term sources of funds (including drawings under both the Group US$2 billion commercial paper programme, and the Group £1 billion euro commercial paper (ECP) programme) are backed by undrawn committed lines of credit and cash. The Group's commercial paper programme is mainly issued by B.A.T. International Finance p.l.c., British American Tobacco Holdings (The Netherlands) B.V. and B.A.T. Netherlands (Finance) B.V. At 31 December 2014, commercial paper of £160 million was outstanding (2013: £521 million).

In May 2014, the Group through B.A.T. International Finance p.l.c. negotiated a new central banking facility of £3 billion with a final maturity of May 2019 (with two additional one-year extensions at the option of the banks). This facility is provided by 22 banks. The new facility is on significantly improved terms compared to the previous central banking facility of £2 billion, with a maturity of December 2015, which was cancelled at the same time. The new facility was undrawn as at 31 December 2014 (2013: undrawn).

In September 2014, the Group signed a one-year bridge facility of US$4.7 billion with an extension option of up to one year for its proposed investment in Reynolds American Inc.

In September 2014, the Group repaid a maturing €600 million bond, this repayment was financed from Group cash balances.

In September 2014, the Group issued a new CHF 350 million bond with a maturity of 2016, a new CHF 400 million bond with a maturity of 2021 and a new CHF 250 million bond with a maturity of 2026.

In August 2014, the Group repaid a maturing MYR 250 million note, this repayment was financed from Group cash balances.

In June 2014, the Group purchased and cancelled an existing US$40 million bond with a maturity of 2029; this purchase was financed from Group cash balances.

In March 2014, the Group issued a new €400 million bond with a maturity of 2018 and a new €600 million bond with a maturity of 2029.

In December 2013, a maturing £152 million bond was repaid, this repayment was financed from Group cash balances.

In November 2013, a maturing US$300 million bond was repaid, this repayment was financed from Group cash balances.

In September 2013, the Group issued a new £650 million bond with a maturity of 2026.

In July 2013, the Group repaid a maturing €519 million bond, this repayment was financed from Group cash balances.

In March 2013, the Group issued a new €650 million bond with a maturity of 2025 and a new US$300 million bond with a maturity of 2016.

During the year, the Group's subsidiary in Brazil received proceeds of £411 million (2013: £399 million) from short-term borrowings in respect of advance payments on leaf export contracts and repaid £271 million (2013: £436 million).

The Group has a US$240 million facility, maturing in 2016. This facility is drawable in Chilean peso and was drawn to the value of US$225 million at 31 December 2014 (2013: US$225 million).

The Group utilises cash pooling and zero balancing bank account structures in addition to inter-company loans and borrowings to ensure that there is the maximum mobilisation of cash within the Group. The key objectives of Treasury in respect of cash and cash equivalents are to protect the principal value of cash and cash equivalents, to concentrate cash at the centre to minimise the required long-term debt issuance, and to optimise the yield earned. The amount of debt issued by the Group is determined by forecasting the net debt requirement after the mobilisation of cash.

The Group continues to target investment-grade credit ratings; as at 31 December 2014 the ratings from Moody's and S&P were A3 (stable outlook)/A- (stable outlook) (2013: A3/A-). The Moody's rating was upgraded from Baa1 to A3 on 12 March 2013. The strength of the ratings has underpinned the debt issuance during 2014 and 2013 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 Swiss franc, euro, US dollar and sterling markets in 2014 and 2013.

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 2014, cash and cash equivalents include £nil invested in money market funds (2013: £156 million).

Subsidiary companies are funded by share capital and retained earnings, loans from the central finance companies on commercial terms, or through local borrowings by the subsidiaries in appropriate currencies. All contractual borrowing covenants have been met and none of them is expected to inhibit the Group's operations or funding plans.

Currency risk

The Group is subject to exposure on the translation of the net assets of foreign currency subsidiaries and associates into its reporting currency, sterling. The Group's primary balance sheet translation exposures are to the US dollar, Canadian dollar, euro, Danish krone, Swiss franc, South African rand, Russian rouble, Brazilian real, Australian dollar, Malaysian ringgit and Singapore dollar. These exposures are kept under continuous review. The Group's policy on borrowings is to broadly match the currency of these borrowings with the currency of cash flows arising from the Group's underlying operations. Within this overall policy, the Group aims to minimise all balance sheet translation exposure where it is practicable and cost-effective to do so through matching currency assets with currency borrowings. The main objective of these policies is to protect shareholder value by increasing certainty and minimising volatility in earnings per share. At 31 December 2014, the currency profile of the Group's gross debt, after taking into account derivative contracts, was 19% (2013: 21%) US dollar, 40% (2013: 41%) euro, 2% (2013: 2%) Canadian dollar, 26% (2013: 21%) sterling, and 13% (2013: 15%) other currencies.

The Group faces currency exposures arising from the translation of profits earned in foreign currency subsidiaries and associates and joint arrangements; these exposures are not normally hedged. Exposures also arise from:

(i) foreign currency denominated trading transactions undertaken by subsidiaries. These exposures comprise committed and highly probable forecast sales and purchases, which are offset wherever possible. The remaining exposures are hedged within the Treasury policies and procedures with forward foreign exchange contracts and options, which are designated as hedges of the foreign exchange risk of the identified future transactions; and

(ii) forecast dividend flows from subsidiaries to the centre. To ensure cash flow certainty, the Group enters into forward foreign exchange contracts which are designated as net investment hedges of the foreign exchange risk arising from the investments in these subsidiaries.

IFRS 7 *Financial Instruments: Disclosures* requires a sensitivity analysis that shows the impact on the Income Statement and on items recognised directly in other comprehensive income of hypothetical changes of exchange rates in respect of non-functional currency financial assets and liabilities held across the Group. All other variables are held constant although, in practice, market rates rarely change in isolation. Financial assets and liabilities held in the functional currency of the Group's subsidiaries, as well as non-financial assets and liabilities and translation risk, are not included in the analysis. The Group considers a 10% strengthening or weakening of the functional currency against the non-functional currency of its subsidiaries as a reasonably possible change. The impact is calculated with reference to the financial asset or liability held as at the year-end, unless this is unrepresentative of the position during the year.

A 10% strengthening of functional currencies against non-functional currencies would result in pre-tax profit being £2 million higher (2013: £24 million higher) and items recognised directly in other comprehensive income being £49 million higher (2013: £15 million higher). A 10% weakening of functional currencies against non-functional currencies would result in pre-tax profit being £3 million lower (2013: £31 million lower) and items recognised directly in other comprehensive income being £59 million lower (2013: £19 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 2014 it is 12.0 times (2013: 12.3 times). The only externally imposed capital requirement the Group has is in respect of its centrally managed banking facilities, which require a gross interest cover of 4.5.

In order to manage its interest rate risk, the Group maintains both floating rate and fixed rate debt. The Group sets targets (within overall guidelines) for the desired ratio of floating to fixed rate debt on both a gross and net basis (at least 50% fixed on a net basis in the short to the medium term) as a result of regular reviews of market conditions and strategy by the Corporate Finance Committee and the Board of the main central finance company. At 31 December 2014, the relevant ratios of floating to fixed rate borrowings were 45:55 (2013: 43:57) on a gross basis and 30:70 (2013: 25:75) 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 *Financial Instruments: Disclosures* 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 £35 million lower (2013: £22 million lower). A 100 basis point decrease in interest rates, or less where applicable, would result in pre-tax profit being £20 million higher (2013: £1 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-/A3. However, the Group recognises that due to the need to operate over a large geographic footprint, sovereign risk can be the determining factor on the suitability of a counterparty. From time to time the Group may invest in short-dated corporate commercial paper and for this, the Group identifies specific counterparties with a minimum short-term rating of A1/P1.

Counterparty credit risk is managed on a global basis by limiting the aggregate amount and duration of exposure to any one counterparty, taking into account its credit rating. The credit ratings of all counterparties are reviewed regularly.

The Group ensures that it has sufficient counterparty credit capacity of requisite quality to undertake all anticipated transactions throughout its geographic footprint, while at the same time ensuring that there is no geographic concentration in the location of counterparties.

With the following exceptions, 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. The Group has issued guarantees to third parties, part of which has been recognised on the Balance Sheet in accordance with IAS 39 *Financial Instruments: Recognition and Measurement.* The unrecognised portion of these guaranteed amounts was £28 million (2013: £30 million). During 2014, the Group has guaranteed the borrowings of the non-controlling interest in respect of the capital injection made to the Group's Algerian business (see note 26(c)). In addition, the Group has entered into short-term risk participation agreements in relation to certain leaf supply arrangements and the maximum exposure under these would be £106 million (2013: £91 million).

The impact of own credit risk on the fair value of derivatives and other obligations held at fair value is not material.

Price risk

The Group is exposed to equity price risk on equity investments held by the Group, which are included in available-for-sale investments on the Consolidated Balance Sheet, but the quantum of such is not material.

Hedge accounting

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

Fair value estimation

The fair values of financial assets and liabilities with maturities of less than one year, other than derivatives, are assumed to approximate their book values. For other financial instruments which are measured at fair value in the Balance Sheet, the basis for fair values is described below.

Fair value hierarchy

The following table presents the Group's financial assets and liabilities that are measured at fair value in accordance with the IFRS 13 classification hierarchy:

	2014			
	Level 1	Level 2	Level 3	Total
	£m	£m	£m	£m
Assets at fair value				
Available-for-sale investments (note 15)	**50**	**—**	**36**	**86**
Derivatives relating to				
- interest rate swaps (note 16)	**—**	**300**	**—**	**300**
- cross-currency swaps (note 16)	**—**	**36**	**—**	**36**
- forward foreign currency contracts (note 16)	**—**	**225**	**—**	**225**
Assets at fair value	**50**	**561**	**36**	**647**
Liabilities at fair value				
Derivatives relating to				
- interest rate swaps (note 16)	**—**	**102**	**—**	**102**
- cross-currency swaps (note 16)	**—**	**23**	**—**	**23**
- forward foreign currency contracts (note 16)	**—**	**124**	**—**	**124**
Liabilities at fair value	**—**	**249**	**—**	**249**

	2013			
	Level 1	Level 2	Level 3	Total
	£m	£m	£m	£m
Assets at fair value				
Available-for-sale investments (note 15)	54	—	36	90
Derivatives relating to				
- interest rate swaps (note 16)	—	121	—	121
- cross-currency swaps (note 16)	—	6	—	6
- forward foreign currency contracts (note 16)	—	298	—	298
Assets at fair value	54	425	36	515
Liabilities at fair value				
Derivatives relating to				
- interest rate swaps (note 16)	—	63	—	63
- cross-currency swaps (note 16)	—	41	—	41
- forward foreign currency contracts (note 16)	—	60	—	60
Liabilities at fair value	—	164	—	164

Level 1 financial instruments are traded in an active market and fair value is based on quoted prices at the year-end.

Level 2 financial instruments are not traded in an active market, but the fair values are based on quoted market prices, broker/dealer quotations, or alternative pricing sources with reasonable levels of price transparency. The Group's level 2 financial instruments include OTC derivatives.

The fair values of level 3 financial instruments have been determined using a valuation technique where at least one input (which could have a significant effect on the instrument's valuation) is not based on observable market data. The Group's level 3 financial instruments primarily consist of an equity investment in an unquoted entity which is valued using the discounted cash flows of estimated future dividends. The valuation assumes the following:

- future dividends grow by 2.0% (2013: 2.0%) and a 100 basis points decrease in the growth rate would result in the valuation being £6 million lower (2013: £6 million lower); and
- discount rate of 6.5% (2013: 6.5%) and a 100 basis points decrease in the discount rate would result in the valuation being £10 million higher (2013: £10 million higher).

The following table presents the changes in level 3 financial instruments:

	2014	2013
	Available-for-sale investments	Available-for-sale investments
	£m	£m
1 January	**36**	37
Differences on exchange	**—**	(1)
31 December	**36**	36

Netting arrangements of derivative financial instruments

The gross fair value of derivative financial instruments as presented in the Group Balance Sheet, together with the Group's rights of offset associated with recognised financial assets and recognised financial liabilities subject to enforceable master netting arrangements and similar agreements, is summarised as follows:

	2014			2013		
	Amount presented in the Group Balance Sheet*	Related amounts not offset in the Group Balance Sheet	Net amount	Amount presented in the Group Balance Sheet*	Related amounts not offset in the Group Balance Sheet	Net amount
	£m	£m	£m	£m	£m	£m
Financial assets						
- Derivative financial instruments (note 16)	**561**	**(227)**	**334**	425	(144)	281
Financial liabilities						
- Derivative financial instruments (note 16)	**(249)**	**227**	**(22)**	(164)	144	(20)
	312	**—**	**312**	261	—	261

* No financial instruments have been offset in the Group Balance Sheet.

The Group is subject to master netting arrangements in force with financial counterparties with whom the Group trades derivatives.

The master netting arrangements determine the proceedings should either party default on their obligations. In case of any event of default: the non-defaulting party will calculate the sum of the replacement cost of outstanding transactions and amounts owed to it by the defaulting party. If that sum exceeds the amounts owed to the defaulting party, the defaulting party will pay the balance to the non-defaulting party. If the sum is less than the amounts owed to the defaulting party, the non-defaulting party will pay the balance to the defaulting party.

25 Cash flow

Cash generated from operations

	2014	2013
	£m	£m
Profit from operations	**4,546**	5,526
Adjustments for		
- amortisation of trademarks and similar intangibles	**58**	74
- amortisation and impairment of other intangible assets	**69**	48
- gain on deemed partial disposal of a trademark	**—**	(26)
- depreciation and impairment of property, plant and equipment	**396**	355
- increase in inventories	**(405)**	(386)
- increase in trade and other receivables	**(36)**	(246)
- increase in trade and other payables	**203**	311
- decrease in net retirement benefit liabilities	**(170)**	(222)
- decrease in provisions for liabilities and charges	**(76)**	(19)
- other non-cash items	**49**	(49)
Cash generated from operations	**4,634**	5,366

Profit from operations includes charges in respect of Group restructuring and integration costs referred to in note 3(e). These are also reflected in the movements in depreciation, amortisation, impairment, inventories, receivables, payables and provisions above and in the proceeds on disposal of property, plant and equipment shown in the Group Cash Flow Statement. The cash outflow in respect of the Group's restructuring costs was £325 million (2013: £310 million).

Profit from operations includes a release in respect of the Fox River provision referred to in note 3(h) and is reflected in the movement in provisions, above. The cash outflow in respect of this provision was £63 million (2013: £nil).

Profit from operations includes a charge in respect of Flintkote referred to in note 3(i) and this corresponds with the cash outflow of £374 million (2013: £nil).

Cash flows from investing activities

(a) Property, plant and equipment

In 2014, proceeds on disposal of property, plant and equipment include receipts in respect of Turkey, Uganda and the Democratic Republic of Congo, the gains on which have been included in restructuring and integration costs (note 3(e)).

In 2013, proceeds on disposal of property, plant and equipment include receipts in respect of Australia, Denmark and Russia, the gains on which have been included in restructuring and integration costs (note 3(e)).

(b) Purchases of investments

The purchases of investments (which comprise available-for-sale investments and loans and receivables) comprise a cash outflow in respect of current investments of £31 million (2013: £47 million outflow).

(c) Proceeds from disposals of investments

The disposals of investments (which comprise available-for-sale investments and loans and receivables) comprise a cash inflow in respect of current investments of £34 million (2013: £15 million inflow).

(d) Proceeds from associates' share buy-backs

The proceeds from associates' share buy-backs reflect proceeds of £94 million (2013: £189 million) in respect of the Group's participation in the share buy-back programme conducted by Reynolds American Inc.

(e) Purchase of subsidiaries

In 2013, the cash outflow relates to further cash consideration paid on the purchase of CN Creative Limited of £16 million.

Cash flows from financing activities

(a) Cash flows from borrowings

In September 2014, the Group repaid a maturing €600 million bond, this repayment was financed from Group cash balances.

In September 2014, the Group issued a new CHF 350 million bond with a maturity of 2016; a new CHF 400 million bond with a maturity of 2021 and a new CHF 250 million bond with a maturity of 2026.

In August 2014, the Group repaid a maturing MYR 250 million note, this repayment was financed from Group cash balances.

In June 2014, the Group purchased and cancelled an existing US$40 million bond with a maturity of 2029; this purchase was financed from Group cash balances.

In March 2014, the Group issued a new €400 million bond with a maturity of 2018 and a new €600 million bond with a maturity of 2029.

In December 2013, a maturing £152 million bond was repaid, this repayment was financed from Group cash balances.

In November 2013, a maturing US$300 million bond was repaid, this repayment was financed from Group cash balances.

In September 2013, the Group issued a new £650 million bond with a maturity of 2026.

In July 2013, the Group repaid a maturing €519 million bond, this repayment was financed from Group cash balances.

In March 2013, the Group issued a new €650 million bond with a maturity of 2025 and a new US$300 million bond with a maturity of 2016.

During the year, the Group's subsidiary in Brazil received proceeds of £411 million (2013: £399 million) from short-term borrowings in respect of advance payments on leaf export contracts and repaid £271 million (2013: £436 million).

(b) Movements relating to derivative financial instruments

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

(c) Purchases of non-controlling interests

In 2014, the purchases of non-controlling interests of £4 million (2013: £nil) relates to the acquisition of part of the non-controlling interests in BAT Chile Operaciones, S.A. and BAT Central America S.A. (see note 26 (c)).

(d) Non-controlling interests — capital injection

In 2014, a £4 million capital injection (2013: £nil) was made by the non-controlling interest to BAT Algérie S.P.A. (see note 26 (c)).

26 Business combinations, disposals and other changes in the Group

(a) CTBAT International Limited

On 30 August 2013 the Group announced that CTBAT International Limited (CTBAT), a joint investment incorporated in Hong Kong between subsidiaries of China National Tobacco Corporation (CNTC) and the Group, had commenced official business operations. The joint venture was created in accordance with the Joint Venture Agreement signed by both companies. It owns and manages the worldwide international cigarette trademark State Express 555, and also, the worldwide rights outside China to the leading CNTC brand, Shuang Xi.

CTBAT is reported as part of the Asia-Pacific region with the majority of its international sales (non-China domestic sales) made through existing end markets of the Group in that region. All sales to mainland China are via CNTC. CTBAT operates as an extension of the existing tobacco businesses of its investors and is therefore treated as a joint operation as defined under IFRS 11 *Joint Arrangements.* The Group recognises its share (50%) of the assets, liabilities, income and expenses of the arrangement on a line-by-line basis in the consolidated financial statements.

The contribution of brands and businesses into CTBAT were recognised by the new entity at fair value, resulting in a gain on the deemed partial disposal of the State Express 555 brand, which was treated as an adjusting item (see note 3(g)).

The impact of the arrangement on operating results for 2014 and 2013 is not material.

(b) British American Tobacco Myanmar Limited

On 8 July 2013, the Group announced the completion of a joint venture in Myanmar with I.M.U. Enterprise Limited to manufacture, distribute and market the Group's brands. Under the terms of the agreement, the Group has contributed plant and machinery and cash to the venture in return for a controlling stake, and will therefore, account for the transaction as a business combination. Goodwill of £1 million in relation to the acquisition of the 51% stake in the business reflects the strategic premium to acquire the opportunity to re-enter the Myanmar market. The Group's proportion of the total net assets acquired at fair value amounted to £8 million with non-controlling interests of £8 million.

(c) Non-controlling interests

BAT Algérie S.P.A.

On 8 June 2014, the Group made a capital injection to BAT Algérie S.P.A. at a cost of £4 million. This injection was in proportion to a capital injection made by the non-controlling interest to the Group company and as such, the Group's shareholding remains unchanged.

BAT Chile Operaciones, S.A.

During 2014, the Group acquired in total a further 1% interest in BAT Chile Operaciones, S.A. at a cost of £3 million. This increased the Group's shareholding to 99%.

BAT Central America S.A.

On 15 December 2014, the Group acquired a further 1% interest in BAT Central America S.A. at a cost of £1 million. This increased the Group's shareholding to 79%.

(d) Items classified as held-for-sale

At 31 December 2014, held-for-sale assets comprised mainly plant and equipment in Souza Cruz and land and buildings in Denmark which were being actively marketed for sale. At 31 December 2013, held-for-sale assets comprised mainly land and buildings in Denmark.

27 Share-based payments

The Group operates a number of share-based payment arrangements of which the two principal ones are:

Long-Term Incentive Plan (LTIP)

Nil-cost options exercisable after three years from date of grant with a contractual life of 10 years. Payout is subject to performance conditions based on earnings per share (50% of grant), total shareholder return (25% of grant) and net turnover (25% of grant). Total shareholder return combines the share price and dividend performance of the Company by reference to one comparator group. 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.

Prior to 2014, payout is subject to performance conditions based on earnings per share relative to inflation (50% of grant) and total shareholder return, combining the share price and dividend performance of the Company by reference to two comparator groups (50% of grant).

Deferred Share Bonus Scheme (DSBS)

Free ordinary shares released three years from date of grant and may be subject to forfeit if a participant leaves employment before the end of the three-year holding period. Participants receive a separate payment equivalent to a proportion of the dividend payment during the holding period. Both equity and cash-settled deferred shares are granted in March each year.

The Group also has a number of other arrangements which are not material for the Group and these are as follows:

Share Option Scheme (ESOS)

Options exercisable three years from date of grant with a contractual life of 10 years, subject to earnings per share performance condition relative to inflation. Participants are not entitled to receive dividends in the period prior to the exercise of the options.

The granting of options under this scheme ceased with the last grant made in March 2004 and final outstanding awards were exercised by March 2014.

Sharesave Scheme (SAYE)

Options granted in March each year from 2011 onwards (previously November until 2009 and no options were granted during 2010) by invitation at a 20% discount to the market price. Options to this equity-settled scheme are exercisable at the end of a three-year or five-year savings contract. Participants are not entitled to dividends prior to the exercise of the options. The maximum amount that can be saved by a participant in this way is £6,000 (2013: £3,000) in any tax year.

Share Reward Scheme (SRS) and International Share Reward Scheme (ISRS)

Free shares granted in April each year (maximum £3,000 in any year) under the equity-settled scheme are subject to a three-year holding period. Participants receive dividends during the holding period which are reinvested to buy further shares.

Partnership Share Scheme

Open to all eligible employees, where employees can allocate part of their pre-tax salary to purchase shares in British American Tobacco p.l.c. The maximum amount that can be allocated in this way to any individual is £1,800 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:

	2014		2013	
	Equity-settled	Cash-settled	Equity-settled	Cash-settled
	£m	£m	£m	£m
LTIP (note (a))	**6**	**1**	8	2
DSBS (note (b))	**54**	**7**	48	11
SAYE (note (c))	**1**	**—**	1	—
SRS (note (c))	**5**	**—**	4	—
Total recognised in the Income Statement (note 3(a))	**66**	**8**	61	13

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 2014 and 2013:

	2014		2013	
	Vested	Unvested	Vested	Unvested
	£m	£m	£m	£m
LTIP	**2.1**	**3.4**	3.8	3.6
DSBS	**0.3**	**17.4**	0.2	14.7
Total liability	**2.4**	**20.8**	4.0	18.3

(a) Long-Term Incentive Plan

Details of the movements for the equity and cash-settled LTIP scheme during the years ended 31 December 2014 and 31 December 2013, were as follows:

	2014		2013	
	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	**5,592**	**709**	5,949	779
Granted during the period	**2,477**	**112**	1,697	131
Exercised during the period	**(1,278)**	**(281)**	(1,508)	(179)
Forfeited during the period	**(1,593)**	**(55)**	(546)	(22)
Outstanding at end of year	**5,198**	**485**	5,592	709
Exercisable at end of year	**376**	**56**	770	123

The weighted average British American Tobacco p.l.c. share price at the date of exercise for share options exercised during the period was £34.40 (2013: £35.41) for equity-settled and £34.57 (2013: £34.97) for cash-settled options.

The outstanding shares for the year ended 31 December 2014 had a weighted average contractual life of 8.4 years (2013: 7.8 years) for the equity-settled scheme, and 8.0 years (2013: 7.6 years) for the cash-settled share-based payment arrangements.

(b) Deferred Share Bonus Scheme

Details of the movements for the equity and cash-settled DSBS scheme during the years ended 31 December 2014 and 31 December 2013, were as follows:

	2014		2013	
	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	**5,105**	**754**	5,368	878
Granted during the period	**1,695**	**175**	1,628	158
Exercised during the period	**(2,486)**	**(367)**	(1,796)	(270)
Forfeited during the period	**(52)**	**(7)**	(95)	(12)
Outstanding at end of year	**4,262**	**555**	5,105	754
Exercisable at end of year	**18**	**4**	—	5

The weighted average British American Tobacco p.l.c. share price at the date of exercise for share options exercised during the financial year was £33.70 (2013: £34.96) for equity-settled and £33.43 (2013: £34.99) for cash-settled options.

The outstanding shares for the year ended 31 December 2014 had a weighted average contractual life of 1.1 years (2013: 1.2 years) for the equity-settled scheme, and 1.0 year (2013: 1.0 year) for the cash-settled scheme.

(c) Other schemes

ESOS

The number of outstanding equity-settled options at the end of the year was nil (2013: 95,266).

SAYE

The number of outstanding options at the end of the year for the three-year scheme was 352,504 (2013: 263,599) and for the five-year scheme was 558,756 (2013: 465,274).

SRS and ISRS

The number of outstanding shares at the end of the year for the Share Reward Scheme was 456,057 (2013: 546,983) and for the International Share Reward Scheme was 34,748 (2013: 41,205).

Valuation assumptions

Assumptions used in the Black-Scholes models to determine the fair value of share options at grant date were as follows:

	2014		2013	
	LTIP	**DSBS**	**LTIP**	**DSBS**
Expected volatility (%)	**18**	**18**	25	25
Average expected term to exercise (years)	**3.5**	**3.0**	3.5	3.0
Risk-free rate (%)	**1.4**	**1.1**	0.4	0.3
Expected dividend yield (%)	**4.2**	**4.2**	3.8	3.8
Share price at date of grant (£)	**32.60**	**32.60**	35.05	35.05
Fair value at grant date (£)*	**17.72**	**19.55**	23.69/23.44	31.23

* Where two figures have been quoted for the Long-Term Incentive Plan, the first number represents the awards made to employees below Management Board level and the second number to awards made to the members of the Management Board, as at the date of award.

Market condition features were incorporated into the Monte-Carlo models for the total shareholder return elements of the LTIP, in determining fair value at grant date. Assumptions used in these models were as follows:

	2014	2013
	%	%
Average share price volatility FTSE 100 comparator group	**—**	37
Average share price volatility FMCG comparator group	**20**	26
Average correlation FTSE 100 comparator group	**—**	37
Average correlation FMCG comparator group	**31**	37

Fair values determined from the Black-Scholes and Monte-Carlo models use assumptions revised at the end of each reporting period for cash-settled share-based payment arrangements.

The expected British American Tobacco p.l.c. share price volatility was determined taking account of the return index, (the share price index plus the dividend reinvested) over a five-year period. The respective FMCG and FTSE 100 share price volatility, and correlations were also determined over the same periods. The average expected term to exercise used in the models has been adjusted, based on management's best estimate, for the effects of non-transferability, exercise restrictions and behavioural conditions, forfeiture and historical experience.

The risk-free rate has been determined from market yield curves for government gilts with outstanding terms equal to the average expected term to exercise for each relevant grant. The expected dividend yield was determined by calculating the yield from the last two declared dividends divided by the grant share price.

In addition to these valuation assumptions, LTIP awards contain earnings per share performance conditions. As these are non-market performance conditions they are not included in the determination of fair value of share options at the grant date, however they are used to estimate the number of awards expected to vest. This pay-out 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 90,118 (2013: 89,820).

	2014 Number	2013 Number
Asia-Pacific	**17,108**	17,156
Americas	**16,011**	16,489
Western Europe	**12,355**	11,824
EEMEA	**12,488**	12,261
Subsidiary undertakings	**57,962**	57,730
Associates	**32,156**	32,090
	90,118	89,820

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.

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 with CTBAT International Limited (see note 26(a)) are not included in these disclosures as it is a joint operation.

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 £96 million (2013: £86 million). The Group's share of dividends from associates, included in other net income in the table below, was £518 million (2013: £512 million).

	2014 £m	2013 £m
Transactions		
- revenue	**38**	54
- purchases	**(279)**	(345)
- other net income	**512**	501
Amounts receivable at 31 December	**98**	96
Amounts payable at 31 December	**(25)**	(33)

On 17 December 2012, a wholly-owned subsidiary of the Group, BATUS Japan Inc. (BATUSJ), entered into an Amendment and Extension Agreement (referred to as the Amendment) with a wholly-owned subsidiary of Reynolds American Inc (RAI), R.J. Reynolds Tobacco Company (referred to as RJRTC). The Amendment modifies the American blend Cigarette Manufacturing Agreement (referred to as the 2010 Agreement), effective as of 1 January 2010.

Prior to the Amendment, the term of the 2010 Agreement was scheduled to expire on 31 December 2014, subject to early termination and extension provisions. Pursuant to the Amendment, the Manufacturing Agreement will remain in effect beyond 31 December 2014, provided that either RJRTC or BATUSJ may terminate the Manufacturing Agreement by furnishing three years' notice to the other party, with any such notice to be given no earlier than 1 January 2016.

During the year, the Group received proceeds of £94 million (2013: £189 million) in respect of its participation in the share buy-back programme conducted by RAI. This programme ceased in the second quarter of 2014.

On 15 July 2014, the Group announced that it has agreed to invest US$4.7 billion as part of RAI's proposed acquisition of Lorillard enabling the Group to maintain its 42% equity position in the enlarged business. The investment is contingent upon the completion of RAI's acquisition of Lorillard, which has been approved by the shareholders of RAI and Lorillard, and the proposed acquisition, while subject to a number of regulatory approvals in the US, is anticipated to be completed in the first half of 2015.

In addition, the Group and RAI have agreed in principle to collaborate on next-generation products and negotiations are ongoing.

During 2014, the Group acquired a further 1% interest in BAT Chile Operaciones, S.A. at a cost of £3 million. This increased the Group's shareholding to 99%. This transaction is shown as a £3 million reduction to reserves attributable to the owners of the parent in note 20.

On 15 December 2014, the Group acquired a further 1% interest in BAT Central America S.A. at a cost of £1 million. This increased the Group's shareholding to 79%. This transaction is shown as a £1 million reduction to reserves attributable to the owners of the parent in note 20.

As explained in note 12, contributions to the British American Tobacco UK Pension Fund are secured by a charge over the Group's Head Office (Globe House) up to a maximum of £150 million.

The key management personnel of British American Tobacco consist of the members of the Board of Directors of British American Tobacco p.l.c. and the members of the Management Board. No such person had any material interest during the year in a contract of significance (other than a service contract) with the Company or any subsidiary company. The term key management personnel in this context includes the respective members of their households.

	2014 £m	2013 £m
The total compensation for key management personnel, including Directors, was:		
- salaries and other short-term employee benefits	**20**	20
- post-employment benefits	**3**	3
- share-based payments	**13**	11
	36	34

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

1. The Group is subject to contingencies pursuant to requirements that it complies with relevant laws, regulations and standards.
2. Failure to comply could result in restrictions in operations, damages, fines, increased tax, increased cost of compliance, interest charges, reputational damage or other sanctions. These matters are inherently difficult to quantify. In cases where the Group has an obligation as a result of a past event existing at the balance sheet date, it is probable that an outflow of economic resources will be required to settle the obligation and if the amount of the obligation can be reliably estimated, a provision will be recognised based on best estimates and management judgment.
3. There are, however, contingent liabilities in respect of litigation, taxes in some countries and guarantees for which no provisions have been made.

General litigation

Product liability litigation

4. Group companies, notably Brown & Williamson Holdings, Inc. (formerly Brown & Williamson Tobacco Corporation) ('B&W') as well as other leading cigarette manufacturers, are defendants in a number of product liability cases. In a number of these cases, the amounts of compensatory and punitive damages sought are significant.

Indemnity

5. On 30 July 2004, B&W completed the combination of the assets, liabilities and operations of its US tobacco business with R.J. Reynolds Tobacco Company ('RJRT'), a wholly-owned subsidiary of R.J. Reynolds Tobacco Holdings, Inc., pursuant to which Reynolds American Inc. was formed (the 'Business Combination'). As part of the Business Combination, B&W contributed to RJRT all of the assets and liabilities of its US cigarette and tobacco business, subject to specified exceptions, in exchange for a 42% equity ownership interest in Reynolds American Inc.
6. As a result of the Business Combination, RJRT assumed all liabilities of B&W (except liabilities to the extent relating to businesses and assets not contributed by B&W to RJRT and other limited categories of liabilities) and contributed subsidiaries or otherwise to the extent related to B&W's tobacco business as conducted in the United States on or prior to 30 July 2004. In addition, RJRT agreed to indemnify B&W and each of its associates (other than Reynolds American Inc. and its subsidiaries) against, among other matters, all losses (including those arising from Environmental Tobacco Smoke ('ETS') claims), liabilities, damages, expenses, judgments, attorneys' fees, etc., to the extent relating to or arising from such assumed liabilities or the assets contributed by B&W to RJRT (the 'RJRT Indemnification').

7. 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').
8. 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.
9. Included in the US Litigation section below are all significant cases where B&W and/or a UK company is named as a defendant and all cases where RJRT is named as a defendant as a successor to B&W (the 'RJRT Successor Cases'). The RJRT Successor Cases are covered by the RJRT Indemnification.

US litigation

10. The total number of US product liability cases pending at 31 December 2014 involving B&W was approximately 6,057 (compared to approximately 7,312 in 2013). Of these, 2,999 cases are RJRT Successor Cases. For all of the 6,057 cases involving B&W, British American Tobacco Group companies have the protection of the RJRT Indemnification. As at 31 December 2014, British American Tobacco (Investments) Limited ('Investments') has been served as a co-defendant in one of those cases (compared to one in 2013). No other UK-based Group company has been served as a co-defendant in any US product liability case pending as at 31 December 2014. 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

11. These civil actions seek to recover amounts spent by government entities and other third-party providers on health care and welfare costs claimed to result from illnesses associated with smoking.
12. At 31 December 2014, one US medical reimbursement suit was pending against B&W by an Indian tribe in an Indian tribal court in South Dakota. No other suits are pending against B&W by county or other political subdivisions of the states.

(b) Class actions

13. At 31 December 2014, B&W was named as a defendant in five separate actions attempting to assert claims on behalf of classes of persons allegedly injured or financially impacted through smoking or where classes of tobacco claimants have been certified. If the classes are or remain certified and the possibility of class-based liability is eventually established, it is likely that individual trials will be necessary to resolve any claims by individual plaintiffs. Class action suits have been filed in a number of states against individual cigarette manufacturers and their parent corporations, alleging that the use of the terms 'lights' and 'ultralights' constitutes unfair and deceptive trade practices.
14. Black is a 'lights' class action filed in November 2000 in the Circuit Court, City of St. Louis, Missouri. B&W removed the case to the US District Court for the Eastern District of Missouri on 23 September 2005. On 25 October 2005, the plaintiffs filed a motion to remand, which was granted on 17 March 2006. On 16 April 2008, the Court stayed the case pending US Supreme Court review in Good v Altria Group, Inc. On 28 June 2011, the Court issued a memorandum removing the case from the trial docket. A status conference is scheduled for 22 February 2016.
15. 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.

16. 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.

17. Parsons is a case filed in February 1998 in the Circuit Court, Ohio County, West Virginia. The plaintiff sued asbestos manufacturers and US cigarette manufacturers, including B&W, seeking compensatory and punitive damages (US$1 million individually and an unspecified sum for the class) for alleged personal injuries arising from their exposure to respirable asbestos fibres and cigarette smoke. The case has been stayed pending a final resolution of the plaintiffs' motion to refer tobacco litigation to the judicial panel on multidistrict litigation filed in In Re: Tobacco Litigation in the Supreme Court of Appeals of West Virginia. Moreover, Parsons has been stayed pursuant to the Bankruptcy Code because three defendants filed bankruptcy petitions on 26 December 2000.

18. Young is a case filed in November 1997 in the Circuit Court, Orleans Parish, Louisiana. The plaintiffs brought an Environmental Tobacco Smoke (ETS) class action on behalf of all residents of Louisiana who, though not themselves cigarette smokers, have been exposed to second-hand smoke from cigarettes which were manufactured by the defendants, and who allegedly suffered injury as a result of that exposure. The plaintiffs seek to recover an unspecified amount of compensatory and punitive damages. On 13 October 2004, the trial court stayed this case pending the outcome of appellate review in the Scott class action in Louisiana. With appellate review completed and final judgment entered in the Scott class action, the trial court granted the plaintiffs' request to continue the stay of this action during the implementation of the Scott smoking cessation programme on 6 March 2013.

19. In Engle (a case in Florida), a jury awarded a total of US$12.7 million to three class representatives, and in a later stage of the three-phase trial procedure adopted in this case, a jury assessed US$17.6 billion in punitive damages against B&W. On 21 May 2003, the intermediate appellate court reversed the trial court's judgment and remanded the case to the trial court with instructions to de-certify the class; this was upheld on 6 July 2006. Further, the Florida Supreme Court permitted the judgments entered for two of the three Engle class representatives to stand, but dismissed the judgment entered in favour of the third Engle class representative. Finally, the Florida Supreme Court permitted putative Engle class members to file individual lawsuits against the Engle defendants within one year of the Court's decision (subsequently extended to 11 January 2008).

20. Engle progeny cases, as at 31 December 2014:

	Engle progeny cases in which B&W has been served (both state and federal courts in Florida)	Engle progeny cases in which RJRT is named as a successor to B&W
Number of cases	42	2,988
Number of plaintiffs	98	3,773

21. Phase three trials of individual Engle class members, as at 31 December 2014:

	Additional Phase 3 Engle Trials naming RJRT as successor to B&W proceeding to verdict
Total number of trials	73
Number of trials resulting in plaintiffs' verdicts	42
Total damages awarded in final judgments against RJRT as successor to B&W (approximately)	US$176,923,848
Amount of overall damages comprising 'compensatory damages' (approximately)	US$90,273,848 (of overall US$176,923,848)
Amount of overall damages comprising 'punitive damages' (approximately)	US$86,650,000 (of overall US$176,923,848)
Number of adverse judgments appealed by RJRT	36 *
Number of adverse judgments (not yet appealed), in which RJRT still has time to file an appeal	0

* Of the 36 adverse judgments appealed by RJRT, 15 were decided and/or closed, and 21 appeals remain undecided (including four that have petitions for review pending in the Florida Supreme Court). In one of the appeals that was decided, the Florida intermediate

appellate court affirmed the liability finding but vacated the damages award and remanded the matter to the trial court. In four of the appeals that were decided, the Florida intermediate appellate courts reversed the final judgment and remanded the matter to the trial court for a new trial on all issues. In another 13 appeals that were decided, the Florida intermediate appellate courts affirmed final judgments in favour of plaintiffs. RJRT has paid damages to plaintiffs in 10 cases that are now closed.

22. In June 2009, the Florida legislature amended its existing bond cap statute by adding a US$200 million bond cap that applies to all phase three Engle progeny cases in the aggregate and establishing individual bond caps for individual cases in amounts that vary depending on the number of judgments in effect at a given time. In May 2011, Florida removed the provision in this legislation that would have permitted this bond cap to expire on 31 December 2012. Plaintiffs in several Engle progeny cases have unsuccessfully challenged the constitutionality of the bond cap. One of these appellate courts has since certified to the Florida Supreme Court the question of whether the bond cap violates the Florida Constitution. The Florida Supreme Court accepted jurisdiction over the issue of the constitutionality of the bond cap on 23 January 2012. On 31 August 2012, the Florida Supreme Court entered an order dismissing this case based on RJRT's mootness argument. Plaintiff subsequently moved for a rehearing. On 12 October 2012, the Florida Supreme Court denied plaintiff's motion. Plaintiff did not file a petition for writ of certiorari to the United States Supreme Court.

(c) Individual cases

	As at:	**Total number of cases**		
Cases pending against B&W which were filed by or on behalf of individuals and in which it is contended that diseases or deaths have been caused by cigarette smoking or by exposure to ETS	31 December 2013	3,063		
	31 December 2014	3,052	2,558	ETS cases brought by flight attendants who were members of a class action ('Broin') that was settled on terms that allow compensatory but not punitive damages claims by class members
			396	Cases brought in consolidated proceedings in West Virginia, where the first phase of the trial began on 15 April 2013 and on 15 May 2013 the jury returned a verdict for defendants on all but one of plaintiffs' claims; the verdict is currently on appeal
			42	Engle progeny cases that have been filed directly against B&W (please see earlier table on page 191)
			56	Cases filed by other individuals

In addition to the 2,988 Engle progeny cases which name RJRT as successor to B&W, there are 11 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.

(d) Conduct-based claims

23. In the Daric Smith case, purchasers of cigarettes in the state of Kansas brought a class action in the Kansas State Court against B&W, Investments and certain other tobacco companies seeking injunctive relief, treble damages, interest and costs. The allegations are that the defendants participated in a conspiracy to fix or maintain the price of cigarettes sold in the US, including in the state of Kansas, in violation of the Kansas Restraint of Trade Act.

24. After the close of discovery, all defendants, including Investments, moved for summary judgment in late October and early November 2010. On 13 May 2011, Investments supplemented its summary judgment motion on the basis of its de minimis market share and the inapplicability of the Kansas Restraint of Trade Act to a non-resident (such as Investments) that did not purchase, sell or manufacture goods in the state of Kansas.

25. On 26 March 2012, the Court entered an order granting all of the defendants' summary judgment motions and dismissing the plaintiff's first amended petition with prejudice. On 18 July 2012, plaintiff filed a notice

of appeal on various points. On or about 1 August 2012, all defendants filed notices of cross-appeal, with Investments filing its own separate notice of cross-appeal to address, amongst other issues, various orders denying the defendants' claims of privilege over certain categories of documents during discovery.

26. The plaintiff filed his appeal on 25 January 2013 and the defendants' opposition and cross-appeal briefs were filed on 29 May 2013. The plaintiff filed his combined reply/response to Investments' cross-appeal on 19 July 2013. Investments filed a reply brief addressing the novel arguments raised in the plaintiff's reply/ response relating to Investments' cross-appeal on privilege issues. The Court of Appeals heard oral argument in the case on 11 December 2013.

27. On 18 July 2014, the Court of Appeals of Kansas affirmed the trial court's order granting summary judgment for all the defendants. On 18 August 2014, the plaintiff filed a Petition for Review by the Supreme Court of Kansas. On 29 August 2014, the defendants filed their response to the plaintiff's Petition for Review. On 12 September 2014, the plaintiff filed his reply. A decision in this matter is pending.

UK-based Group companies

Investments has been served in the following US cases pending as at 31 December 2014: one class action alleging violations of Kansas antitrust and consumer protection laws, the Daric Smith case mentioned above; and one individual action, the Perry case.

Product liability outside the United States of America

28. As at 31 December 2014, active product liability claims against the Group's companies existed in 15 markets outside the US (2013:16) but the only markets with more than five claims were Argentina, Brazil, Canada, Chile, Italy and Nigeria. As at 31 December 2014, medical reimbursement actions are being brought in Argentina, Brazil, Canada, Nigeria and South Korea.

(a) Medical reimbursement cases

Argentina

29. In 2007, the non-governmental organisation the Argentina Tort Law Association ('ATLA') and Emma Mendoza Voguet brought a reimbursement action against Nobleza Piccardo S.A.I.C.y.F. ('Nobleza') and Massalín Particulares. Several defences were filed by Nobleza on 1 October 2009. Nobleza and the federal government's preliminary objections regarding lack of jurisdiction were considered by the Civil Court in late 2009. On 23 December 2009, the Civil Court declared its lack of jurisdiction to hear the claim. On 11 March 2010, the case was sent to the Contentious-Administrative Court, which determined that it had jurisdiction over the case. On 24 June 2011, the Contentious-Administrative Court issued an Order stating that it would decide the defendants' outstanding procedural objections together with the merits of the case. The case is currently at the evidentiary stage. Confessional hearings took place on 14 August 2013 (Emma Mendoza Voguet) and 29 August 2013 (ATLA). In February 2014, plaintiffs renounced several of their prior evidentiary requests that included a request for copies of certain historical advertising published by Nobleza. In April 2014, plaintiffs filed a motion seeking to revoke this prior renunciation. In September 2014 the Contentious-Administrative Court rejected the motion and plaintiffs have not appealed this rejection.

Brazil

30. In August 2007, the São Paulo Public Prosecutor's Office filed a medical reimbursement claim against Souza Cruz S.A. ('Souza Cruz'). A similar claim was lodged against Philip Morris. On 4 October 2011, the Court dismissed the action against Souza Cruz, with a judgment on the merits. The plaintiff filed an appeal on 9 January 2012 and Souza Cruz filed its counter arguments on 17 February 2012. On 29 September 2012, the case records arrived at the São Paulo Court of Appeals.

31. On 7 March 2013, the case records returned from the Public Prosecutor's Office with a non-binding unfavourable opinion. On 23 April 2013, the Justices of the 2nd Civil Chamber of the Court of Appeals of the State of São Paulo, by unanimous vote (3 to 0), denied the appeal of the Prosecution Office, thereby confirming the favourable Lower Court ruling. In this ruling, the Justices, citing case precedents of the Superior Court of Justice, emphasised: (i) the widespread public knowledge of the risks associated with smoking cigarettes; (ii) the free will of the smokers; (iii) the absence of any defect in the product; (iv) the

absence of any duty to provide information on the risks associated with smoking before 1988; and (v) the lawfulness of manufacturing and producing cigarettes. The Public Prosecutor's Office has filed a Special Appeal and the case is anticipated to be sent for judgment to Superior Court of Justice within several months.

Canada

32. In Canada there are 10 active statutory actions for recovery of health care costs arising from the treatment of smoking and health-related diseases. These proceedings name various Group companies as defendants, including the Company, Investments, B.A.T Industries p.l.c. ('Industries'), Carreras Rothmans Limited (collectively the 'UK Companies') and Imperial Tobacco Canada Limited ('Imperial'), the Group's operating company in Canada. Legislation enabling provincial governments to recover the health care costs has been enacted in all 10 provinces and two of three territories in Canada and has been proclaimed in force in 10 provinces. The Acts have received Royal Assent in Northwest Territories and Nunavut but have yet to be proclaimed into force. Actions have begun against various Group companies, including Imperial, in British Columbia, New Brunswick, Newfoundland and Labrador, Ontario, Quebec, Manitoba, Alberta, Saskatchewan, Nova Scotia and Prince Edward Island ('PEI'). In Quebec, three Canadian manufacturers, including Imperial, are challenging the enabling legislation; the Quebec government has commenced an action.

33.

Canadian province	Act pursuant to which claim was brought	Companies named as defendants and date served	Current stage
British Columbia	Tobacco Damages and Health Care Costs Recovery Act 2000	Imperial. Investments. Industries. Other former Rothmans Group companies.	The underlying medical reimbursement action remains at a preliminary case management stage. Damages have not been quantified by the province. Given the prior pendency of the Supreme Court application, and a number of other factors including delay on the part of the plaintiff in producing damages modelling materials, the trial date was adjourned generally and no trial date is currently set. The federal government has commenced a cost assessment in connection with the motion and appeals relating to the federal government claim, seeking CAD$5 million jointly from all the defendants and an additional CAD$5 million from Imperial. No hearing date has been set.
New Brunswick	Tobacco Damages and Health Care Costs Recovery Act 2006	The UK Companies have all been named as defendants. Imperial and the UK Companies have all been served.	Both Imperial and the UK Companies have now filed their defences and document production by the defendants is substantially complete. A first round of oral discoveries of the province began in September 2014 and will continue at least through the end of Q2 of 2015. Damages have been quantified at CAD$19 billion. No trial date has been set.
Ontario	Tobacco Damages and Health Care Costs Recovery Act 2009	The UK Companies have all been named as defendants.	On 5–7 November 2012, appeals by the BAT defendants of both the jurisdictional and costs orders were heard by the Court of Appeal.

Canadian province	Act pursuant to which claim was brought	Companies named as defendants and date served	Current stage
		Imperial and the UK Companies have all been served.	On 30 May 2013, the Court of Appeal dismissed the appeals and upheld the adverse costs award in respect of the first instance hearing. A motion for leave to appeal that decision to the Supreme Court of Canada was filed in August 2013. The Supreme Court of Canada dismissed the leave application on 19 December 2013. On 22 October 2013, the Court of Appeal issued an endorsement awarding the plaintiff its costs of the appeals. Imperial filed a third-party notice against several native manufacturers claiming contribution and indemnity as well as damages in the amount of CAD$1.5 billion. Imperial also filed a Third Party Claim against the Federal government claiming malfeasance in public office due to the government's failure to enforce the law against illicit manufacturers. These claims have been discontinued. Following the Supreme Court of Canada's dismissal of the jurisdiction leave application, the case is under case management. The province has stated its claim to be worth CAD$50 billion, but has not yet tendered evidence to substantiate this figure. No trial date has been set.
Newfoundland and Labrador	Tobacco Health Care Costs Recovery Act 2006	The UK Companies have all been named as defendants. Imperial and the UK Companies have all been served.	There have been preliminary hearings, including a successful application in January 2012 to strike certain affidavits filed by the plaintiff in opposition to the UK Companies' jurisdiction motions, and a hearing in June 2013 at which, in response to a request of the case management judge, the parties debated the elements of the 'legal framework' for a jurisdiction challenge. Judgment in respect of that hearing was issued on 19 December 2013. Jurisdiction has been resolved. Particulars and other preliminary motions were filed on 16 January 2015, and a case management conference took place on 22 January 2015. The hearing on the preliminary motions is scheduled for 4–6 March 2015, and a further case management conference is scheduled for 16 April 2015. Damages have not been quantified by the province.

Canadian province	Act pursuant to which claim was brought	Companies named as defendants and date served	Current stage
Saskatchewan	Tobacco Damages and Health Care Costs Recovery Act 2012	The UK Companies have all been named as defendants. Imperial and the UK Companies have all been served.	This case is at an early case management stage. The UK Companies challenged the jurisdiction of the Saskatchewan court at a hearing that commenced on 29 April 2013. On 1 October 2013, the Court denied the UK Companies' challenges. Leave to appeal this ruling was sought and a hearing was scheduled for 11 December 2013. This hearing was adjourned on consent of the parties pending the outcome of the Supreme Court of Canada leave application in the Ontario jurisdiction challenge. The leave application was dismissed on 19 December 2013. No further case management meetings have been set. Damages have not been quantified by the province. No trial date has been set. Imperial served a motion (which was granted) to defer filing defences until pending jurisdictional challenges have been resolved. There are no discovery motions to date in this jurisdiction. Jurisdiction has been resolved. A standstill agreement has been negotiated under which the next step would be to file defences by 27 February 2015 and the matter will remain in abeyance until document production begins in September 2017.
Manitoba	Tobacco Damages Health Care Costs Recovery Act 2006	Imperial. Investments. Industries. Other former Rothmans Group companies.	Imperial served a motion (which was denied) to defer filing defences until pending jurisdictional challenges have been resolved. Imperial delivered a request for particulars on 30 September 2013. The province filed a response on 16 January 2014. The jurisdiction motions were scheduled to be heard on 25–28 November 2013. This hearing was adjourned on consent of the parties pending the outcome of the Supreme Court of Canada leave application in the Ontario jurisdiction challenge. The leave application was dismissed on 19 December 2013. Particulars motions have been argued and defences have been filed. Damages have not been quantified by the province. No trial date has been set. A standstill agreement has been negotiated,

Canadian province	Act pursuant to which claim was brought	Companies named as defendants and date served	Current stage
			under which the next step will be document production to commence in January in 2017.
Alberta	Crown's Right of Recovery Act 2009	Imperial and the UK Companies have all been named as defendants and served.	On 8 August 2012, Imperial was served with the Alberta Medicaid suit. The UK Companies were served on 15 May 2013. The UK Companies informed the plaintiff that they intended to challenge the jurisdiction of the Alberta court.
			A case management judge has been appointed and an initial case management meeting was held on 17 December 2013 at which it was agreed to put preliminary matters on hold pending the outcome of the Supreme Court of Canada leave application in the Ontario jurisdiction challenge. The leave application was dismissed on 19 December 2013. Case management is ongoing. Particulars motions have been filed and were argued on 26 and 27 January 2015. Judgment was reserved.
			The province has stated its claim to be worth CAD$10 billion, but has not yet tendered evidence to substantiate this figure. No trial date has been set.
Quebec	Tobacco Related Damages and Health Care Costs Recovery Act 2005	Investments, Industries, and Carreras Rothmans Limited have been named as defendants.	On 25 August 2009, Imperial and the other Canadian manufacturers filed a constitutional challenge to the Quebec Medicaid Legislation. The Quebec Attorney-General (AG) filed a motion to dismiss the constitutional challenge and following a hearing, the Quebec Superior Court dismissed that motion.
		Imperial and the UK Companies have been served.	On 28 January 2011, the Court of Appeal denied the AG's leave application, permitting Imperial's challenge to proceed.
			On 8 June 2012, the Quebec Medicaid suit was served upon Imperial. The government is seeking CAD$60 billion. On 14 December 2012, Imperial's motion to stay the Medicaid suit pending the resolution of the constitutional challenge, was heard by the Court and taken under advisement. It was subsequently dismissed.
			The Constitutional Challenge was heard on 30 September–3 October 2013 and was subsequently dismissed.

Canadian province	Act pursuant to which claim was brought	Companies named as defendants and date served	Current stage
			The three UK Companies filed jurisdictional challenges on 15 March 2013 which were heard on 3–5 June 2013. On 4 July 2013, the Court denied the jurisdictional objections. Leave to appeal the ruling was refused in a judgment issued by a Court of Appeal judge on 4 October 2013. Defendants' motions for further and better particulars and concerning other pleadings issues were heard on 15 and 22 November and 20 December 2013 and judgment was reserved. A case management judge has been appointed. Motions for particulars have been completed, defences filed, document subpoenas served on the AG and requests to admit the authenticity of documents were responded to on 21 January 2015. No trial date has been set.
Prince Edward Island	Tobacco Damages and Health Care Costs Recovery Act 2009	Imperial and the UK Companies.	On 15 November 2012, Imperial was served with the PEI Medicaid suit. Damages have not been quantified by the province. This case is at a preliminary case management stage. Motions to challenge jurisdiction were filed and served by the UK Companies on 11 January 2013. A case management judge has been appointed. A standstill agreement has been negotiated. Defences are to be filed by 27 February 2015 and the next step will be document production, which will commence in September 2017.
Nova Scotia	Tobacco Health Care Costs Recovery Act 2005	Imperial and the UK Companies.	On 22 January 2015 Imperial and the UK Companies were served with the Nova Scotia Medicaid suit. Damages have not been quantified by the province. A standstill agreement has been negotiated. Under the agreement, the defendants must deliver statements of defence or demands for particulars by 31 March 2015. If demands for particulars are delivered, the responses from the province are due by 15 May 2015. Statements of defence are to be filed by 3 July 2015, and document production by the defendants is to commence on or before 1 September 2017.

Nigeria

34. As at 31 December 2014, six medical reimbursement actions filed by the federal government and five Nigerian states (Lagos, Kano, Gombe, Oyo, Ogun) were pending in the Nigerian courts. British American Tobacco (Nigeria) Limited ('BAT Nigeria'), the Company and Investments have been named as defendants in each of the cases. The plaintiffs in the six cases seek a total of approximately £44.8 billion in damages, including special, anticipatory and punitive damages, restitution and disgorgement of profits, as well as declaratory and injunctive relief. On 13 and 25 May 2010, respectively, the plaintiffs in the Kano and Ogun state cases filed motions for preliminary injunctive relief, seeking, inter alia, orders to restrain the defendants from various alleged marketing and distribution practices including the sale of tobacco products within 1,000 metres of any public places that are predominantly locations for minors. The Company and Investments have filed preliminary objections challenging the jurisdiction of the Nigerian courts over them. On 22 June 2010, the Oyo High Court partially granted the Company's and Investments' preliminary objections and set aside the service of the writ of summons. The Company and Investments appealed the Court's order insofar as it denied the remainder of the relief requested, and the Court of Appeal has yet to set a date for hearing of the appeals.

35. The Federal High Court and the High Courts of Lagos, Kano, Gombe and Ogun states denied the preliminary objections filed by the Company and Investments, and the companies have appealed. High Court proceedings in the Lagos and Kano state cases have been stayed pending the appeals filed by the Company and Investments. In the Gombe and Ogun cases, the High Courts have adjourned proceedings without date, pending the resolution of appeals filed by the Company, Investments and BAT Nigeria. As at 31 December 2014, the appeal filed by the Company in the Lagos case and the appeals filed by the Company and Investments in the Federal and Kano cases remain pending and have yet to be heard by the Court of Appeal. On 23 April 2013 and 16 May 2013, the Court of Appeal (Ibadan Judicial Division) issued decisions affirming the Ogun High Court's denial of the preliminary objections filed by the Company, Investments and BAT Nigeria. On 13 June 2014, the Court of Appeal (Jos Judicial Division) affirmed the denial of the Company's and Investments' preliminary objections in the Gombe action, and on 30 June 2014 the Court of Appeal (Lagos Judicial Division) affirmed the denial of Investments' preliminary objections in the Lagos action. The companies have appealed the decisions to the Supreme Court of Nigeria.

South Korea

36. In April 2014, Korea's National Health Insurance Service ('NHIS') filed a health care recoupment action against KT&G (the state-owned former monopoly), PM Korea and BAT Korea (including BAT Korea Manufacturing). The lawsuit relates to health care costs allegedly incurred by the NHIS treating patients with lung (small cell and squamous cell) and laryngeal cancer between 2003 and 2012. The claim is based on allegations of defective design, failure to warn, fraud/misrepresentation, marketing to youth, use of additives and causing addiction. The NHIS is seeking damages of roughly £32 million from the defendants.

Spain

37. In early 2006, the Government of Andalusia and the Andalusian Health Services (hereinafter referred to as the 'Junta'), in Spain, filed a medical reimbursement action against the State and tobacco companies (including BAT España S.A.) before the contentious-administrative courts. The State filed preliminary objections to the Junta's claim, with tobacco companies filing supporting briefs. The Court upheld these preliminary objections and dismissed the claim in November 2007. The Junta's appeal of this ruling to the Supreme Court was dismissed in September 2009. However, in May 2009, the Junta filed a new contentious-administrative claim with similar allegations. The defendants filed procedural objections, which were rejected by the Court.

38. On 31 May 2013, the Court notified BAT España of the commencement of a 20-day period to answer the Junta's claim and produced copies of the documents attached to the statement of claim. BAT España filed its response to the claim by the deadline of 27 June 2013.

39. By order dated 26 July 2013, the Court refused to open the evidence phase of the proceedings. The Court accepted the defendants' allegations that the Junta did not fulfil its procedural duty to establish the issues of fact to which the evidence would relate. In October 2013, the Court declared the proceedings closed pending its judgment. In a judgment dated 23 December 2013, the Court rejected the Junta's claim against the

tobacco companies as inadmissible. The Junta did not appeal the decision and the judgment became final in February 2014. This case is now closed and will be removed from future reports.

(b) Class actions

Brazil

40. There are currently two class actions being brought in Brazil. One is also a medical reimbursement claim (São Paulo Public Prosecutor's Office), and is therefore discussed above. A third class action ended in July 2014 when a judgment in favour of the defendants became final, as described below.

41. In 1995, the Associação de Defesa da Saúde do Fumante ('ADESF') class action was filed against Souza Cruz and Philip Morris in the São Paulo Lower Civil Court alleging that the defendants are liable to a class of smokers and former smokers for failing to warn of cigarette addiction. The case was stayed in 2004 pending the defendants' appeal from a decision issued by the Lower Civil Court that held that the defendants had not met their burden of proving that cigarette smoking was not addictive or harmful to health, notwithstanding an earlier interlocutory order that the São Paulo Court of Appeals had issued, which directed the trial court to allow more evidence to be taken before rendering its decision. On 12 November 2008, the São Paulo Court of Appeals overturned the lower court's unfavourable decision of 2004, finding that the lower court had failed to provide the defendants with an opportunity to produce evidence. The case was returned to the lower court for production of evidence and a new judgment. On 19 March 2009, the Lower Civil Court ordered designation of court-appointed medical and advertising experts. The parties submitted questions to these court-appointed experts who subsequently delivered their reports. Each party also provided expert reports commenting on the court-appointed experts' conclusions. On 16 May 2011, the Court granted Souza Cruz's motion to dismiss the action in its entirety on the merits. Plaintiffs filed an appeal of the dismissal on 22 July 2011. Souza Cruz filed its response on 5 October 2011. On 10 November 2011, the case records were sent to the Public Prosecutor's Office. On 20 December 2011, the Public Prosecutor's Office presented a non-binding, advisory opinion that rejected most of Souza Cruz's legal defence arguments. The case records were sent to the São Paulo State Court of Appeals and were immediately sent to the Public Prosecutor's Office for General Public and Collective Interest. On 1 March 2012, the case files returned with an unfavourable opinion given by the Public Prosecutor, who advised that the Court should find in favour of the appeal brought by ADESF and thereby fully reverse the appealed judgment. On 6 September 2012, the case was assigned to a new temporary Reporting Justice in the 7th Chamber of Private Law of the São Paulo Court of Appeals, pending reference to a permanent Reporting Justice of the case. On 10 October 2013, a Reporting Justice of the case was designated. At a hearing on 28 January 2015, the Court reserved its decision on the appeal pending further consideration, with no designated deadline for reaching a decision.

42. The Brazilian Association for the Defense of Consumers' Health ('Saudecon') filed a class action against Souza Cruz and Philip Morris in the City of Porto Alegre, Brazil on 3 November 2008. The plaintiff purported to represent all Brazilian smokers whom, it alleged, were unable to quit smoking and lack access to cessation treatments. On 18 December 2013, the Rio Grande do Sul State Court rendered a decision in favour of defendants, based on free will, awareness and lawful activity. The plaintiff did not appeal the decision and the judgment became final on 2 July 2014. This case is now closed and will be removed from future reports.

Canada

43. There are 10 class actions being brought in Canada against Group companies.

44. Knight is a 'lights' class action in which the plaintiff alleges that the marketing of light and mild cigarettes is deceptive because it conveys a false and misleading message that those cigarettes are less harmful than regular cigarettes. Although the claim arises from health concerns, it does not seek compensation for personal injury. Instead it seeks compensation for amounts spent on 'light and mild' products and a disgorgement of profits from Imperial.

45. The Supreme Court of British Columbia certified a class of all consumers who purchased in British-Columbia Imperial cigarettes bearing 'light' or 'mild' descriptors since 1974. Imperial filed an appeal against the certification which was heard in February 2006. The appellate court confirmed the certification of the class but has limited any financial liability, if proven, to 1997 onward.

46. The motion of the federal government to strike out the third-party notice issued against it by Imperial was upheld by the Supreme Court which dismissed the third-party claim on the basis that the federal government's impugned conduct constituted valid policy benefiting public health and was therefore not subject to civil liability. The federal government is seeking a parallel cost order in this action as it is in the British Columbia government recoupment case.
47. On 9 December 2009, Imperial was served with a class action filed by Ontario tobacco farmers and the Ontario Flue-Cured Tobacco Growers' Marketing Board ('Growers' claim'). The plaintiffs allege that, during a specific timeframe, Imperial and two other domestic defendants improperly paid lower prices for tobacco leaf destined for duty-free products and then were smuggled back into Canada and sold in the domestic market. In reaction to the suit, Imperial deposited the amount owing to the government of Ontario, pursuant to the Comprehensive Agreement, into an escrow account, alleging that the Comprehensive Agreement permitted Imperial to set-off that amount against costs incurred as a result of the claim (including damages, if any). In response, the Ontario government commenced an application against Imperial, seeking the release of the funds ('Ontario claim'). No monetary damages are being claimed against Imperial by the government of Ontario.
48. On 26 July 2010, Imperial argued a preliminary motion in the Ontario claim seeking a stay in favour of arbitration given an arbitration clause in the Comprehensive Agreement. Imperial was successful in its application and the Court ordered that the Ontario claim be stayed. The Court of Appeal denied the Ontario government's appeal in July 2011, but also ruled that the question of whether the Growers' claim constitutes a 'Released Claim' under the Comprehensive Agreement must be determined by the courts, thereby splitting the issues. On 2 January 2013, the Court rendered a decision in favour of Ontario and held that the Growers' claim is not a 'Released Claim' brought by a 'Releasing Entity'. On 16 July 2013, the Court of Appeal dismissed Imperial's appeal on whether the Growers' claim is a 'Released Claim' made by a 'Released Entity', allowing the class action to proceed.
49. The question of whether Imperial may continue to set-off payments due to Ontario under the Comprehensive Agreement against costs incurred as a result of the Growers' claim proceeded to arbitration in September 2014. By decision dated 24 October 2014, the tribunal ruled against Imperial, holding that the Growers' claim was not captured by the set-off provisions of the Comprehensive Agreement. Imperial has now released the previously escrowed funds, plus accrued interest.
50. As a further preliminary challenge, Imperial has alleged that the Growers' claim is time barred. The other domestic defendants have made the same preliminary challenge. That preliminary issue was heard by the Court on 30 and 31 January 2014. By decision dated 30 June 2014, the Court dismissed the preliminary challenge. Imperial and the domestic defendants have sought leave to appeal that decision. If Imperial is ultimately successful, the Growers' claim will be dismissed; if not successful, the action will proceed to a class action certification hearing.
51. There are currently two class actions in Quebec. On 21 February 2005, the Quebec Superior Court granted certification in two class actions against Imperial and two other domestic manufacturers, which have a combined value of CAD$21 billion plus interest and costs. The Court certified two classes, which include residents of Quebec who suffered from lung, throat and laryngeal cancer or emphysema as of November 1998 or developed these diseases thereafter and who smoked a minimum of 15 cigarettes a day for at least five years, and residents who were addicted to nicotine at the time the proceedings were filed and who have since remained addicted. The plaintiffs' application to amend the scope of the definition of the disease and addiction classes was granted on 3 July 2013. The trial in this matter commenced on 12 March 2012 and was completed in December 2014. Judgment is anticipated in 2015 and is appealable.
52. 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, the Company and Carreras Rothmans have been released from the action. No date has been set for the certification motion hearing. There are service issues in relation to the UK Companies in Alberta and Manitoba.
53. In July 2010, two further smoking and health class actions in British Columbia were served on Imperial and the UK Companies. The Bourassa claim is allegedly on behalf of all individuals who have suffered chronic respiratory disease and the McDermid claim proposes a class based on heart disease. Both claims state that

they have been brought on behalf of those who have "smoked a minimum of 25,000 cigarettes". The UK Companies objected to jurisdiction. Subsequently a number of the UK Companies were released from the action. No certification motion hearing date has been set. In Bourassa, the case management judge ordered the claim to be amended which has been done. Plaintiffs were due to deliver certification motion materials by 31 January 2015, but have not yet done so. Once the materials are delivered, the motions regarding abuse of process will be dealt with.

54. In June 2012, a new smoking and health class action was filed in Ontario against the domestic manufacturers and foreign companies, including Imperial and the UK Companies. Imperial was served on 20 November 2012, and the UK Companies were served on 30 November 2012. The claim is presently in abeyance.

Italy

55. In or about June 2010, BAT Italia was served with a class action filed in the Civil Court of Rome by the consumer association, Codacons, and three class representatives. Plaintiffs primarily asserted addiction-related claims. The class action lawsuit was rejected at the first instance (Civil Court of Rome) and appellate (Rome Court of Appeal) court levels. In July 2012, Codacons filed an appeal before the Italian Supreme Court. BAT Italia filed its answer to the appeal on 13 November 2012. At a hearing on 21 January 2015, the Public Prosecutor's Office agreed that the appeal should be rejected, and the Supreme Court reserved its decision with no firm date for issuing judgment.

Venezuela

56. In April 2008, the Venezuelan Federation of Associations of Users and Consumers and Giorgio Di Muro Di Nunno, the president of the Association of Users of Electric Services of Venezuela ('ASUSELECTRIC'), not ASUSELECTRIC itself, filed a class action against the Venezuelan government. The class action seeks 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.

57. On 12 April 2011, however, the Constitutional Chamber of the Supreme Court of Justice issued decision number 494, which established the rules for class action procedures. On 5 December 2012 Cigarrera Bigott was admitted as a third-party and presented its defences and evidence on 26 February 2013. The parties will now be asked to attend a hearing at the Constitutional Chamber; however, no date for the hearing has yet been scheduled by the Court. On 23 October 2014, ASUSELECTRIC, which is not a party to the case, filed a petition requiring the Constitutional Chamber to schedule the hearing.

(c) Individual personal injury claims

58. As at 31 December 2014, the jurisdictions with the most number of active individual cases against Group companies were, in descending order: Brazil (141), Italy (26), Argentina (20), Chile (11), Canada (5) and Ireland (2). There were a further four jurisdictions with one active case only.

Non-tobacco related litigation

Flintkote

59. The Flintkote Company ('Flintkote'), a US company formerly engaged in the production and sale of asbestos-containing products, was included in the acquisition of Genstar Corporation by Imasco Limited in 1986 and became a Group subsidiary following the restructuring of Imasco Limited (now Imperial Tobacco Canada Limited ('Imperial'), the Group's operating company in Canada) in 2000. Soon after this acquisition, and as part of the acquisition plan, Genstar Corporation began to sell most of its assets, including the non-asbestos related operations and subsidiaries of Flintkote. The liquidation of Flintkote assets produced cash proceeds and, having obtained advice from the law firm of Sullivan & Cromwell LLP ('S&C') and other advice that sufficient assets would remain to satisfy reasonably foreseeable liabilities, Flintkote's Board of Directors authorised the payment of a dividend of US$170.2 million in 1986 and a further dividend of

US$355 million in 1987. In 2003, Imperial divested Flintkote and then, in 2004, Flintkote filed for bankruptcy in the United States Bankruptcy Court for the District of Delaware. In 2006, Flintkote, representatives of both the present and future asbestos plaintiffs (collectively, the 'Flintkote Plaintiffs'), and certain individual asbestos plaintiffs (the 'Hopkins Plaintiffs') were permitted by the Bankruptcy Court to file a complaint in the California State Court against Imperial and numerous other defendants, including a malpractice claim against S&C, for the recovery of the dividends and other compensation under various legal and equitable theories.

60. Following a multi-day bench trial, the California State Court issued a preliminary decision dismissing the claim against S&C. Before the decision was made final, Flintkote settled with S&C for a nominal sum. All claims and cross claims in the litigation asserted by or against S&C have now been dismissed. After another series of bench trials, on 6 October 2011, the Court issued preliminary orders deciding multiple preliminary issues regarding Flintkote's claims to recover the dividends and Flintkote's claim that Imperial is its 'alter ego' for purposes of asbestos liabilities. Among other things, the Court has concluded that Flintkote is barred from seeking to recover, under any theory, transfers that occurred after 31 December 1986. The Court also concluded that Flintkote has no standing to pursue its claim that Imperial is its alter ego for purposes of asbestos liability, holding that any such claims must instead be pursued by individual asbestos plaintiffs. These rulings were made final on 6 January 2012. Thereafter, the Flintkote Plaintiffs agreed to dismiss certain of their claims, but continued to assert fraudulent conveyance claims and equitable restitution claims, as reflected in the Third Amended Complaint filed in January 2013. In August 2013, the Court implemented certain of its earlier decisions by granting summary judgment to Imperial on the plaintiffs' claims to recover the 1987 dividends. The Court also granted summary judgment to Imperial on the plaintiffs' fraudulent conveyance claims that were based on allegations that Flintkote was insolvent at the time of the dividend. Nonetheless, Flintkote continued to pursue claims that effectively sought recovery of the value of the 1987 dividend plus interest. Procedurally, the claims of the Flintkote Plaintiffs are now separated from the claims of the Hopkins Plaintiffs, and it is anticipated that, in the absence of the settlement described below, they would be tried separately.

61. On 17 December 2014, following a series of formal mediation sessions and other negotiations, Imperial and the Flintkote Plaintiffs executed a settlement agreement. In furtherance of this settlement, Imperial has placed into escrow the required settlement payment of US$575 million. The settlement is contingent upon further documentation and approval of the United States Bankruptcy Court for the District of Delaware, where Flintkote's bankruptcy case remains pending, and the United States District Court for the District of Delaware. Imperial filed bankruptcy motions and plan documents on 9 February 2015. The settlement will finally and completely resolve the existing Flintkote litigation, including the claims of the Hopkins Plaintiffs, and Imperial and its corporate affiliates will obtain protections from any potential future litigation related to Flintkote. On 4 February 2015 Imperial went before the California Superior Court to stay proceedings pending the settlement approval process. It is anticipated that final court approval of the settlement will occur in Q3 2015.

Reynolds American, Inc/Lorillard, Inc. Shareholder Litigation

62. On 15 July 2014, Reynolds American, Inc ('Reynolds') announced that it had entered into a definitive merger agreement with Lorillard Inc. ('Lorillard'), whereby Reynolds would acquire Lorillard in exchange for a combination of cash and Reynolds stock. As part of this transaction, the Company executed a Share Purchase Agreement to acquire a sufficient number of Reynolds shares to achieve a 42% equity stake in Reynolds after the merger with Lorillard, which is the same equity ownership it currently holds in Reynolds. In press releases announcing the transaction, Reynolds and BAT also announced that they had 'agreed in principle' to pursue a technology-sharing initiative for the development and commercialisation of next-generation tobacco products.

63. In summer 2014, the Company was named as a defendant in three actions stemming from the announcement of Reynolds' intended acquisition of Lorillard and related transactions (the 'Proposed Transaction'). Two of these actions were filed in the Delaware Court of Chancery on behalf of a putative class of Lorillard shareholders alleging that the directors of Lorillard breached their fiduciary duties by failing to obtain the highest value for Lorillard and that Reynolds and the Company aided and abetted that breach. Nine other

related actions were filed in Delaware by Lorillard shareholders that did not name the Company as a defendant. All 11 Delaware actions were consolidated on 25 November 2014, and the Company was not named as a defendant in the consolidated action.

64. The third action against the Company was filed in state court in North Carolina on 8 August 2014. The action was brought on behalf of a putative class of Reynolds shareholders alleging that the Company is a controlling shareholder of Reynolds and breached its fiduciary duty to the other Reynolds shareholders by 1) entering into the Share Purchase Agreement to acquire Reynolds shares at an allegedly unfair price in order to maintain its 42% interest in Reynolds after the Lorillard acquisition while diluting the interest of the other shareholders, and 2) entering into a purported agreement with Reynolds under which the plaintiff contends Reynolds will share next-generation technology with BAT for inadequate consideration. The plaintiff also alleges certain claims against Reynolds and its directors. The plaintiff seeks to enjoin the Proposed Transaction and to recover damages in an unspecified amount and attorneys' fees and costs.

65. On 5 December and 8 December 2014, all defendants moved to dismiss the Amended Complaint and to stay discovery pending the motions to dismiss. On 2 January 2015, the plaintiff filed a motion for a preliminary injunction to enjoin the vote of Reynolds shareholders regarding aspects of the Proposed Transaction pending additional disclosures to shareholders regarding issues that the plaintiff contended were material to the vote. On 17 January 2015, Reynolds and its directors settled the disclosure claims with the plaintiff pursuant to a Memorandum of Understanding filed with the Court and the plaintiff withdrew his motion for a preliminary injunction. The Court has not yet scheduled oral argument on the motions to dismiss, but it is expected to occur in the first half of 2015.

Fox River

Background to environmental liabilities arising out of contamination of the Fox River

66. In Wisconsin, the authorities have identified potentially responsible parties ('PRPs') to fund the clean-up of river sediments in the lower Fox River. The pollution was caused by discharges of Polychlorinated Biphenyls ('PCBs') from paper mills and other facilities operating close to the river. Among the PRPs is NCR Corporation ('NCR').

67. There has been a substantial amount of litigation in the US regarding the responsibility for the costs of the clean-up operations. This can be summarised as follows:

    a. As regards the mid and lower portions of the Fox River:

        i. NCR was initially made subject to an injunction filed by the US Government against it and Appvion Inc. ('Appvion') in the courts of Wisconsin in 2012.

        ii. A subsequent ruling by the same Court in April 2012 found that Appvion was not a PRP, and the injunction was accordingly granted against NCR alone. NCR sought to appeal this decision, but it was affirmed on 3 August 2012.

        iii. A full trial of the merits of the US Government's application for a permanent injunction took place in December 2012 and the Court entered a permanent injunction against NCR.

        iv. On 1 May 2013, the Wisconsin Court ruled that the pollution in the Fox River is not divisible. In a series of rulings, the Wisconsin Court also held that NCR was not entitled to recover any amounts in contribution from other PRPs and that the other PRPs were entitled to recover Fox River clean-up costs from NCR. Cross-claims by Appvion against other PRPs to recover its own Fox River related expenditures were rejected by the Wisconsin Court on 25 June 2013. As a result of these decisions NCR was found wholly responsible for the clean-up of those portions of the river. NCR and Appvion appealed against these decisions.

        v. On 25 September 2014, the US Court of Appeals for the Seventh Circuit:

            1. vacated the decisions finding NCR wholly liable. The Court remanded the case to the district court for further consideration of defence of divisibility available to NCR. The Court also vacated the permanent injunction against NCR, reasoning that such relief is unnecessary;

            2. remanded the issue of contribution to the district court for reconsideration; and

3. found that Appvion is entitled to bring actions against other PRPs to recover its expenses, thereby reversing the trial court's finding in relation to this.

vi. As a result of the findings of the US Court of Appeals for the Seventh Circuit, a trial of the matters remanded back to the district court is currently set to commence on 13 June 2016.

b. As regards the upper portion of the Fox River:

i. In July 2012, the Wisconsin Court ruled that NCR was not liable for the clean-up costs in the upper portion of the Fox River. This judgement considered whether NCR was liable as a result of the sale, by a predecessor of NCR's Appleton Papers Division, of scrap paper, or 'broke', to other PRPs which, in turn, discharged PCBs into the upper portion of the river in the course of recycling the broke. This order was made final on 27 June 2013.

ii. On 25 September 2014, the US Court of Appeals for the Seventh Circuit dismissed the other PRPs' appeal against this order.

68. In NCR's Form 10-Q Quarterly Report for the quarterly period ended 30 September 2014, the total clean-up costs for the Fox River are estimated at US$825 million. This estimate is subject to uncertainties and does not include natural resource damages which NCR estimates may range from US$0 to US$246 million (albeit the US Government in one court filing in 2009 indicated that natural resource damages could be as high as US$382 million). There are however ongoing proceedings that may ultimately lead to the dismissal of all claims for natural resource damages.

Industries' involvement with environmental liabilities arising out of the contamination of the Fox River

69. Industries' involvement with the environmental liabilities arises out of indemnity arrangements which it became party to due to a series of transactions that took place from the late-1970s onwards. US authorities have never identified Industries or BATUS as PRPs.

70. In 1978, a subsidiary of Industries, later known as Appleton Papers Inc. and now known as Appvion, purchased what was then NCR's Appleton Papers Division from NCR. Under the terms of the agreement, Industries and Appvion both provided indemnities to NCR concerning certain environmental liabilities. In 1978, Industries also incorporated a US entity by the name of BATUS, Inc. ('BATUS') which in 1980 became the holding company for all of Industries' US subsidiaries, including Appvion. As the holding company, BATUS obtained insurance policies for itself and its subsidiaries that included coverage for certain environmental liabilities. Industries/BATUS spun off the Appvion business in 1990 via a Demerger Agreement with Wiggins Teape Appleton p.l.c., now known as Windward Prospects Ltd ('Windward'), and Wiggins Teape Appleton (Holdings) p.l.c., now known as Arjo Wiggins US Holdings Ltd (collectively, the 'AWA Entities'), obtaining what Industries believes were full indemnities from the AWA Entities and Appvion for past and future environmental claims.

71. Disputes between NCR, Appvion, and Industries as to the indemnities given and received under the original purchase agreement in 1978 have been the subject of litigation that was commenced in 1995, a settlement agreement effective from 1998 (the 'Settlement Agreement'), and an arbitration award in 2005. NCR took the position that, under the terms of the Settlement Agreement and the arbitration award, Industries and Appvion generally had a joint and several obligation to bear 60% of the Fox River environmental remediation costs imposed on NCR. Until May 2012, Appvion and the AWA Entities paid the 60% share of the clean-up costs and Industries was never required to contribute.

72. Following the May 2013 ruling of the Wisconsin Court described above which found, in April 2012, that Appvion was not a PRP, Appvion and the AWA Entities ceased making payments in relation to the clean-up. That led to NCR making demands on Appvion and Industries for payments under the terms of the Settlement Agreement. NCR later commenced an arbitration against Appvion on 29 March 2013 seeking US$39.9 million (plus interest and cost; later this rose to US$80.7 million) and a declaration that Appvion was liable to NCR under the Settlement Agreement for 60% of all 'Claims, Damages and Group Defence Costs' (as defined in the Settlement Agreement). An arbitration award has been finalised, but under the terms of the Funding Agreement described below, the parties have agreed that the award will not be released.

Litigation surrounding Windward's indemnities to Appvion and to Industries

73. In December 2011, following a request by Industries to confirm its indemnity obligation, 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 disputed Windward's position and commenced proceedings in the High Court against both Windward and Appvion (which has also denied owing Industries an indemnity) (the 'English Indemnity Proceedings'). Appvion also issued a Counterclaim seeking recovery of 50% of its previous clean-up related payments (alleged to be 50% of US$211.25 million, or US$105.6 million) (the 'Appvion Counterclaim'). These proceedings were scheduled to go to trial in June 2015, but have now been discontinued pursuant to the Funding Agreement, described below.

74. The refusal of Appvion and Windward to continue to pay clean-up costs after May 2012 led to NCR making the demands on Industries referenced above. This led to Industries investigating the respective financial positions of Appvion and Windward. Industries is aware that Windward settled the majority of Appvion's insurance claims (over which it had control) at what Industries believes constituted a significant discount, and has made dividend payments to its former and current shareholders of approximately US$810 million, leaving it holding, according to its latest accounts for the year ended 31 October 2013, approximately US$60 million of net assets. Appvion's own accounts indicated that it also had limited financial resources. Accordingly, Industries considered that there was a significant risk that the assets of Windward/Appvion would be insufficient to meet their obligations under the indemnities Industries believes it was granted.

75. In order to preserve the value of the assets within Windward, Industries applied to the High Court of Justice of England and Wales (the 'High Court') seeking to appoint a receiver over claims Industries considered Windward has against its former shareholder, Sequana S.A. ('Sequana') and the former directors of Windward, in relation to the dividend payments. Judgement was handed down on 21 November 2013, with the judge finding that, absent an appropriate undertaking from Windward that it would commence the claims in question, receivers should be appointed in order to commence the dividend claims in its name. Windward commenced its claim against Sequana and the former Windward directors on 9 May 2014. Industries filed its own direct claims seeking to recover the dividend payments from Sequana in both the High Court and before the Commercial Court of Nanterre, France, in December 2013.

Funding Agreement of 30 September 2014

76. On 30 September 2014, Industries entered into the Funding Agreement with Windward, Appvion, NCR and BTI 2014 LLC (a wholly-owned subsidiary of Industries). Pursuant to the Funding Agreement, the English Indemnity Proceedings, Appvion Counterclaim and the NCR-Appvion arbitration described above were discontinued as part of an overall agreement between the parties providing a framework through which they would together fund the ongoing costs of the Fox River clean-up. Under the agreement, NCR has agreed to accept funding by BAT at the lower level of 50% of the ongoing clean-up related costs of the Fox River (rather than the 60% referenced above; this remains subject to an ability to litigate the extent to which a further 10% of the costs ought to be allocated at a later stage). In addition Windward and Appvion each committed to contribute to the funding — Windward has contributed US$10 million and Appvion will contribute up to a maximum of US$25 million respectively for each of Fox River and Kalamazoo River (see further below). The parties have also agreed to cooperate in order to maximise recoveries from certain claims that exist against third parties, including those claims which exist against Sequana (as referenced above). Any proceeds resulting from third-party claims will be applied to meet river clean-up costs first, thereby reducing Industries' obligations under the Funding Agreement and Industries then ranks first in the agreed repayment waterfall should surplus remain. Windward has provided Industries with an agreed direct indemnity to potentially cover shortfalls in recoveries by Industries against the amounts paid out. The Funding Agreement also assigned the claims which Windward has against Sequana, as well as certain claims against former advisers to Windward, to BTI 2014 LLC.

77. Sequana is seeking to challenge Windward's ability to enter into the Funding Agreement, on the basis of certain restrictions it alleges affect its ability to do so. The trial of this issue is scheduled to take place on 22 June 2015. The Funding Agreement contains provisions that mean that it will be set aside as between all of the parties to it if this challenge is successful, and the disputes between the parties described above will be revived.

78. The sums Industries has agreed to pay under the Funding Agreement are subject to ongoing adjustment, as clean-up costs can only be estimated in advance of the work being carried out and as certain sums payable are the subject of ongoing US litigation. In addition, Sequana's challenge referred to above is yet to be determined. Based on information currently at hand, Industries believes it may have a further exposure of some £177 million (as at 31 December 2014 and after payment of £56 million in 2014) in relation to clean-up related costs. Accordingly, Industries has retained a provision of £177 million, after releasing £27 million from the provision created in 2011 to the Income Statement as an adjusting item — see note 22 'Provisions'.

Kalamazoo

79. Industries is aware that NCR is also being pursued by Georgia-Pacific, as the owner of a facility on the Kalamazoo River in Michigan which released PCBs into that river. Georgia-Pacific has been designated as a PRP in respect of the river.

80. Georgia-Pacific contends that NCR is responsible for, or should contribute to, the clean-up costs, because:

    a. a predecessor to NCR's Appleton Papers Division sold 'broke' containing PCBs to Georgia-Pacific or others for recycling;

    b. NCR itself sold paper containing PCBs to Georgia-Pacific or others for recycling; and/or

    c. 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.

81. A full trial on liability took place in February 2013. On 26 September 2013, the Michigan Court held that NCR was liable as a PRP on the basis that broke sales constituted an arrangement for the disposal of hazardous material for the purposes of CERCLA. The decision was based on NCR's knowledge of the hazards of PCBs from at least 1969, but the Court did not specify directly the entity(ies) whose broke sales form the basis of NCR's liability. NCR will have the ability to appeal the ruling once a final judgement has been entered or it has been otherwise certified for appeal.

82. The second phase of the Kalamazoo trial, scheduled to commence on 22 September 2015, will determine the apportionment of liability amongst NCR, Georgia-Pacific and the other PRPs (International Paper Company and Weyerhauser Company). Industries anticipates that NCR may seek to recover from Appvion and/or Industries 60% of any Kalamazoo clean-up costs for which it is found liable on the basis, it would be asserted, that the river constitutes a 'Future Site' for the purposes of the Settlement Agreement. Industries believes it may have defences to any such claim by NCR. The Funding Agreement described above does not resolve any such claims, but does provide an agreed mechanism pursuant to which any surplus from the valuable recoveries of any third-party claims that remains after all Fox River related clean-up costs have been paid and Industries and NCR have been made whole may be applied towards Kalamazoo clean-up costs, in the event that NCR were to be successful in any claim for a portion of them from Industries or Appvion. The quantum of the clean-up costs for the Kalamazoo River is presently unclear (as is the extent of NCR's liability in respect of such costs), but could run into the hundreds of millions of dollars.

83. As detailed above, Industries is taking active steps to protect its interests, including seeking to procure the repayment of the Windward dividends, pursuing the other valuable claims that are now within its control, and working with the other parties to the Funding Agreement to maximise recoveries from third parties with a view to ensuring that amounts funded towards clean-up related costs are later recouped under the agreed repayment mechanisms.

General litigation conclusion

84. 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 judgement 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 judgement. In any event, the Group has the benefit of the RJRT Indemnification with regard to US litigation, excluding the litigation brought by the shareholders of

Reynolds and Lorillard. 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.

85. Having regard to all these matters, with the exception of Fox River, the Group (i) does not consider it appropriate to make any provision in respect of any pending litigation; and (ii) does not believe that the ultimate outcome of this litigation will significantly impair the Group's financial condition.

Tax disputes

The Group has exposures in respect of the payment or recovery of a 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 Group's accounting policies. In some countries, tax law requires that full or part payment of disputed tax assessments be made pending resolution of the dispute. To the extent that such payments exceed the estimated obligation, they would not be recognised as an expense.

The following matters may proceed to litigation:

Brazil

The Brazilian Federal Tax Authority has filed claims against Souza Cruz seeking to reassess the profits of overseas subsidiaries to corporate income tax and social contribution tax. The first reassessment was for the years 2004–2006 in the sum of R$495 million (£119 million) to cover tax, interest and penalties. The second reassessment was for the years 2007 and 2008 in the amount of R$248 million (£60 million) to cover tax, interest and penalties.

Souza Cruz appealed both reassessments and the matters are at the second tier administrative appeal process. Regarding the first assessment the Souza Cruz appeal was rejected although the written judgment of that tribunal is still awaited. The appeal against the second assessment was upheld at the second tier tribunal and is closed. There is one further administrative appeal level before the matter enters the judicial system.

Souza Cruz received a further reassessment in 2014 for 2009 in the sum of R$219 million (£53 million) covering tax, interest and penalties and have appealed against the reassessment in full.

Canada

The Canada Revenue Agency (CRA) had challenged the treatment of dividend income received by Imperial Tobacco Canada Ltd (ITCAN) from its investments in fellow group subsidiaries. Following the outcome of other cases in Canada, CRA have decided not to pursue the matter. A refund of payments made by ITCAN to pursue the appeal has been received from the federal and provincial authorities, including interest, with CAD$53 million (£29 million) being refunded in 2014 and the final balance of CAD$10 million (£5 million) being received in January 2015.

South Africa

In 2011 SARS challenged the debt financing of British American Tobacco South Africa (BATSA) and reassessed the years 2006 to 2008. BATSA has objected to and appealed this reassessment. In 2014, SARS have also reassessed the years 2009 and 2010. BATSA have filed a detailed objection letter to the 2009/10 reassessments. Across the period from 2006 to 2010 the reassessments are for R1.74 billion (£96 million) covering both tax and interest.

The Group believes that the Group's companies have meritorious defences in law and fact in each of the above matters and intends to pursue each dispute through the judicial system as necessary. The Group does not consider it appropriate to make provision for these amounts assessed nor for any potential further amounts which may be assessed in subsequent years.

While the amounts that may be payable or receivable in relation to tax disputes could be material to the results or cash flows of the Group in the period in which they are recognised, the Board does not expect these amounts to have a material effect on the Group's financial condition.

VAT and duty disputes

Bangladesh

The operating company received a retrospective notice of imposition and realisation of VAT and supplementary duty on low price category brands from the National Board of Revenue (NBR) for approximately £158 million. The company is alleged to have evaded tax by selling the products in the low price segments rather than the mid-tier price segments.

Litigation has proceeded during 2014. A High Court Order to conclude the NBR hearing in 120 days (by 24 March 2015) was served to the Commissioner on 24 November 2014. Hearings scheduled for January and February 2015 were postponed and a new date for the hearing of the case by the NBR has not been set. The Ministry of Law has issued an opinion in respect of retrospective claims, supporting the company's view.

Operating leases

Total future minimum lease payments under non-cancellable operating leases comprise leases where payments fall due:

	2014 £m	2013 £m
Property		
Within one year	**52**	55
Between one and five years	**117**	114
Beyond five years	**25**	29
	194	198
Plant and equipment		
Within one year	**24**	25
Between one and five years	**40**	40
	64	65

31 Interests in subsidiaries

Subsidiaries with material non-controlling interests

Non-controlling interests principally arise from the Group's listed investments in Brazil (Souza Cruz SA) and Malaysia (British American Tobacco (Malaysia) Berhad) where the Group held 75% and 50% of the respective listed holding companies in both 2014 and 2013. The Group has assessed that it exercises de facto control over Malaysia as it has the practical ability to direct the business through effective control of the Company's Board as a result of the Group controlling the largest shareholding block in comparison to other shareholdings which are widely dispersed. Summarised financial information for these subsidiaries is shown below as required by IFRS 12 *Disclosure of Interests in Other Entities.* As part of the Group's reporting processes, both entities report consolidated financial information for their respective groups which have been adjusted to comply with Group accounting policies which may differ to local accounting practice. Goodwill in respect of Malaysia, which arose as a result of the acquisition of the Rothmans Group referred to in note 9, has not been included as part of the net assets below. No adjustments have been made to the information below for the elimination of inter-company transactions and balances with the rest of the Group.

Summarised financial information	Souza Cruz Group		Malaysia Group	
	2014	2013	2014	2013
	£m	£m	£m	£m
Revenue	**1,602**	1,838	**485**	504
Profit for the year	**441**	504	**167**	167
- Attributable to non-controlling interests	***111***	*126*	***84***	*84*
Total comprehensive income	**380**	388	**167**	167
- Attributable to non-controlling interests	***95***	*94*	***83***	*83*
Dividends paid to non-controlling interests	**(98)**	(117)	**(82)**	(81)
Summary net assets:				
Non-current assets	**399**	424	**55**	61
Current assets	**1,236**	1,261	**93**	104
Non-current liabilities	**(106)**	(118)	**(8)**	(7)
Current liabilities	**(899)**	(908)	**(131)**	(152)
Held for sale assets	**13**	—	**—**	—
Total equity at the end of the year	**643**	659	**9**	6
- Attributable to non-controlling interests	***174***	*181*	***4***	*3*
Net cash generated from operating activities	**380**	588	**182**	166
Net cash generated/(used) in investing activities	**211**	61	**2**	(5)
Net cash used in financing activities	**(474)**	(619)	**(195)**	(165)
Differences on exchange	**(31)**	(63)	**1**	(1)
Increase/(decrease) in net cash and cash equivalents	**86**	(33)	**(10)**	(5)
Net cash and cash equivalents at 1 January	**358**	391	**11**	16
Net cash and cash equivalents at 31 December	**444**	358	**1**	11

Other shareholdings

In Principal subsidiary and other Group undertakings, the Group discloses that it holds 85% (2013: 85%) of the equity shares of PT Bentoel Internasional Investama Tbk ('Bentoel'). In 2011, the Group sold 984 million shares, representing approximately 14% of Bentoel's share capital, for the purposes of fulfilling certain obligations pursuant to Bapepam LK (Indonesia) takeover regulations. The Group simultaneously entered into a total return swap on 971 million of the shares. As a consequence of this and for the duration of the swap, while the Group does not have legal ownership of these shares, it retains the risks and rewards which results in the Group continuing to recognise an effective interest in 99% of Bentoel's net assets and results.

32 Post balance sheet date announcement

On 23 February 2015, the Group announced that it is evaluating a possible public tender offer to acquire up to all of the 24.7% of Souza Cruz shares which are not currently owned by British American Tobacco and to delist the company.

An offer for Souza Cruz's shares would be at a price per share of R$26.75, to be paid in cash, in Brazilian reais, and to be reduced by any dividend paid by Souza Cruz. A price of R$26.75 per share would represent a premium of 30.0% to Souza Cruz's volume weighted average closing price over the three months to Friday 20 February 2015.

REYNOLDS AMERICAN INC.

CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(Dollars in Millions, Except Per Share Amounts)
(Unaudited)

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2017	2016	2017	2016
Net sales (1)	$3,290	$3,141	$6,201	$ 6,003
Net sales, related party	28	54	66	109
Net sales	3,318	3,195	6,267	6,112
Costs and expenses:				
Cost of products sold (1)	1,278	1,275	2,477	2,440
Selling, general and administrative expenses	478	499	896	964
Gain on divestiture	—	—	—	(4,861)
Amortization expense	6	6	12	12
Operating income	1,556	1,415	2,882	7,557
Interest and debt expense	150	152	299	326
Interest income	(3)	(2)	(5)	(5)
Other expense (income), net	11	(1)	15	251
Income before income taxes	1,398	1,266	2,573	6,985
Provision for income taxes	479	470	874	2,624
Net income	$ 919	$ 796	$1,699	$ 4,361
Net income per share:				
Basic	$ 0.64	$ 0.56	$ 1.19	$ 3.06
Diluted	$ 0.64	$ 0.56	$ 1.19	$ 3.05
Dividends declared per share	$ 0.51	$ 0.42	$ 1.02	$ 0.84

(1) Excludes excise taxes of $1,083 million and $1,120 million for the three months ended June 30, 2017 and 2016, respectively; and $2,065 million and $2,150 million for the six months ended June 30, 2017 and 2016, respectively.

See Notes to Consolidated Financial Statements (Unaudited)

REYNOLDS AMERICAN INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Dollars in Millions)
(Unaudited)

	For the Three Months Ended June 30,	
	2017	2016
Net income	$ 919	$ 796
Other comprehensive income (loss), net of tax (benefit) expense:		
Retirement benefits, net of tax (2017 — $9; 2016 — $25)	13	39
Long-term investments, net of tax (2016 — $2)	—	4
Cumulative translation adjustment and other, net of tax (2017 — $5; 2016 — $(2))	11	(5)
Comprehensive income	$ 943	$ 834

	For the Six Months Ended June 30,	
	2017	2016
Net income	$1,699	$4,361
Other comprehensive income, net of tax expense:		
Retirement benefits, net of tax (2017 — $5; 2016 — $21)	9	33
Long-term investments, net of tax (2016 — $3)	—	3
Hedging instruments, net of tax (2016 — $6)	—	11
Cumulative translation adjustment and other, net of tax (2017 — $6; 2016 — $9)	14	17
Comprehensive income	$1,722	$4,425

See Notes to Consolidated Financial Statements (Unaudited)

REYNOLDS AMERICAN INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Dollars in Millions)
(Unaudited)

	For the Six Months Ended June 30,	
	2017	2016
Cash flows from (used in) operating activities:		
Net income	$ 1,699	$ 4,361
Adjustments to reconcile to net cash flows from (used in) operating activities:		
Gain on divestiture	—	(4,861)
Loss on early extinguishment of debt and related expenses	—	239
Depreciation and amortization expense	63	61
Deferred income tax expense (benefit)	(10)	104
Pension and postretirement	(88)	(397)
Tobacco settlement accruals	(663)	(1,114)
Income taxes	61	770
Other, net	215	112
Net cash flows from (used in) operating activities	1,277	(725)
Cash flows from (used in) investing activities:		
Capital expenditures	(66)	(94)
Proceeds from settlement of investments	—	182
Proceeds from divestiture	—	5,015
Other, net	1	—
Net cash flows from (used in) investing activities	(65)	5,103
Cash flows from (used in) financing activities:		
Dividends paid on common stock	(1,384)	(1,113)
Repurchase of common stock	(139)	(149)
Borrowings under revolving credit facility	500	—
Repayments of borrowings under revolving credit facility	(500)	—
Early extinguishment of debt	—	(3,650)
Premiums paid for early extinguishment of debt	—	(207)
Proceeds from termination of interest rate swaps	—	66
Debt financing fees	—	(7)
Excess tax benefit on stock-based compensation plans	—	26
Net cash flows used in financing activities	(1,523)	(5,034)
Effect of exchange rate changes on cash and cash equivalents	18	7
Net change in cash and cash equivalents	(293)	(649)
Cash and cash equivalents at beginning of period	2,051	2,567
Cash and cash equivalents at end of period	$ 1,758	$ 1,918
Income taxes paid, net of refunds	$ 804	$ 1,699
Interest paid	$ 325	$ 378

See Notes to Condensed Consolidated Financial Statements (Unaudited)

REYNOLDS AMERICAN INC.

CONDENSED CONSOLIDATED BALANCE SHEETS
(Dollars in Millions)

	June 30, 2017 (Unaudited)	December 31, 2016
Assets		
Current assets:		
Cash and cash equivalents	$ 1,758	$ 2,051
Accounts receivable	123	66
Accounts receivable, related party	1	113
Other receivables	11	10
Inventories	1,448	1,645
Other current assets	295	353
Total current assets	3,636	4,238
Property, plant and equipment, net of accumulated depreciation (2017 — $1,534; 2016 — $1,662)	1,338	1,348
Trademarks and other intangible assets, net of accumulated amortization	29,432	29,444
Goodwill	15,992	15,992
Other assets and deferred charges	65	73
	$50,463	$51,095
Liabilities and shareholders' equity		
Current liabilities:		
Accounts payable	$ 193	$ 221
Tobacco settlement accruals	1,833	2,498
Due to related party	—	7
Deferred revenue, related party	106	66
Current maturities of long-term debt	1,748	501
Dividends payable on common stock	727	656
Other current liabilities	935	1,036
Total current liabilities	5,542	4,985
Long-term debt (less current maturities)	11,390	12,664
Long-term deferred income taxes, net	9,614	9,607
Long-term retirement benefits (less current portion)	1,768	1,869
Long-term deferred revenue, related party	19	39
Other noncurrent liabilities	244	220
Commitments and contingencies:		
Shareholders' equity:		
Common stock (shares issued: 2017 — 1,426,238,791; 2016 — 1,425,824,955)	—	—
Paid-in capital	18,197	18,285
Retained earnings	3,980	3,740
Accumulated other comprehensive loss	(291)	(314)
Total shareholders' equity	21,886	21,711
	$50,463	$51,095

See Notes to Condensed Consolidated Financial Statements (Unaudited)

Notes to Condensed Consolidated Financial Statements (Unaudited)

Note 1 — Business and Summary of Significant Accounting Policies

Overview

The condensed consolidated financial statements (unaudited) include the accounts of Reynolds American Inc., referred to as RAI, and its wholly owned subsidiaries. RAI's wholly owned operating subsidiaries include R. J. Reynolds Tobacco Company; Santa Fe Natural Tobacco Company, Inc., referred to as SFNTC; American Snuff Company, LLC, referred to as American Snuff Co.; R. J. Reynolds Vapor Company, referred to as RJR Vapor; Niconovum USA, Inc.; Niconovum AB; and until their sale on January 13, 2016, as described below, SFR Tobacco International GmbH, referred to as SFRTI, and various foreign subsidiaries affiliated with SFRTI.

On January 16, 2017, RAI, British American Tobacco p.l.c., referred to as BAT, BATUS Holdings Inc., an indirect, wholly owned subsidiary of BAT, and Flight Acquisition Corporation, an indirect, wholly owned subsidiary of BAT, referred to as Merger Sub, entered into an Agreement and Plan of Merger, as it and the plan of merger contained therein were amended on June 8, 2017, referred to as the Merger Agreement, pursuant to which, subject to the satisfaction or waiver of certain conditions, Merger Sub would merge with and into RAI, referred to as the BAT Merger, with RAI surviving as an indirect, wholly owned subsidiary of BAT. Pursuant to the terms of the Merger Agreement, the BAT Merger was completed on July 25, 2017. For additional information related to the BAT Merger, see note 14.

RAI was incorporated as a holding company in the State of North Carolina in 2004, and, prior to the completion of the BAT Merger, its common stock was listed on the New York Stock Exchange, referred to as NYSE, under the symbol "RAI." RAI was created to facilitate the business combination of the U.S. business of Brown & Williamson Holdings, Inc., referred to as B&W, an indirect wholly owned subsidiary of BAT, with R. J. Reynolds Tobacco Company, a wholly owned subsidiary of R.J. Reynolds Tobacco Holdings, Inc., referred to as RJR, on July 30, 2004, with such combination referred to as the B&W business combination.

References to RJR Tobacco prior to July 30, 2004, relate to R. J. Reynolds Tobacco Company, a New Jersey corporation. References to RJR Tobacco on and subsequent to July 30, 2004 and until June 12, 2015, relate to the combined U.S. assets, liabilities and operations of B&W and R. J. Reynolds Tobacco Company. Concurrent with the completion of the B&W business combination, RJR Tobacco became a North Carolina corporation. References to RJR Tobacco on and subsequent to June 12, 2015, relate to R. J. Reynolds Tobacco Company, a North Carolina corporation, and reflect the effects of (1) RAI's acquisition, referred to as the Lorillard Merger, on June 12, 2015, of Lorillard, Inc., n/k/a Lorillard, LLC, referred to as Lorillard, and (2) the divestiture, referred to as the Divestiture, of certain assets, on June 12, 2015, by subsidiaries or affiliates of RAI and Lorillard, together with the transfer of certain employees and certain liabilities, to a wholly owned subsidiary of Imperial Brands PLC.

Sale of International Rights to the NATURAL AMERICAN SPIRIT Brand

On January 13, 2016, RAI, through various subsidiaries, referred to as the Sellers, completed the sale of the international rights to the NATURAL AMERICAN SPIRIT brand name and associated trademarks, along with SFRTI and other international companies that distributed and marketed the brand outside the United States to JT International Holding BV, referred to as JTI Holding, a subsidiary of Japan Tobacco Inc., referred to as JTI, in an all-cash transaction of approximately $5 billion and recognized a pre-tax gain of approximately $4.9 billion. The transaction did not include the rights to the NATURAL AMERICAN SPIRIT brand name and associated trademarks in the U.S. market, U.S. duty-free locations and U.S. territories or in U.S. military outlets, all of which were retained by SFNTC. With this transaction completed, the international rights to nearly all of RAI's operating companies' cigarette trademarks are now owned by international tobacco companies. For additional information regarding indemnities related to this sale, see note 7.

Operating Segments

RAI's reportable operating segments are RJR Tobacco, Santa Fe and American Snuff. The RJR Tobacco segment consists of the primary operations of R. J. Reynolds Tobacco Company. The Santa Fe segment consists of the primary operations of SFNTC. The American Snuff segment consists of the primary operations of American Snuff Co. Included in All Other, among other RAI subsidiaries, are RJR Vapor, Niconovum USA, Inc., Niconovum AB, and until their sale on January 13, 2016, as described above, SFRTI and various foreign subsidiaries affiliated with SFRTI. The segments were identified based on how RAI's chief operating decision maker allocates resources and assesses performance. Certain of RAI's operating subsidiaries have entered into intercompany agreements for products or services with other subsidiaries. As a result, certain activities of an operating subsidiary may be included in a different segment of RAI. For additional information regarding segments, see note 10.

RAI's operating subsidiaries primarily conduct their businesses in the United States.

Basis of Presentation

The accompanying interim condensed consolidated financial statements (unaudited) have been prepared in accordance with accounting principles generally accepted in the United States of America, referred to as GAAP, for interim financial information and, in management's opinion, contain all adjustments, consisting only of normal recurring items, necessary for a fair presentation of the results for the periods presented. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. All material intercompany balances have been eliminated. For interim reporting purposes, certain costs and expenses are charged to operations in proportion to the estimated total annual amount expected to be incurred primarily based on sales volumes. The results for the interim periods ended June 30, 2017, are not necessarily indicative of the results that may be expected for a full fiscal year.

The condensed consolidated financial statements (unaudited) should be read in conjunction with the consolidated financial statements and related footnotes, which appear in RAI's Annual Report on Form 10-K for the year ended December 31, 2016. Certain reclassifications were made to conform prior years' financial statements to the current presentation. Certain amounts presented in note 7 are rounded in the aggregate and may not sum from the individually presented components. All dollar amounts, other than per share amounts, are presented in millions, except for amounts set forth in note 7 and as otherwise noted.

Cost of Products Sold

Cost of products sold includes, among other expenses, the expenses for the Master Settlement Agreement, referred to as the MSA, and other settlement agreements with the States of Mississippi, Florida, Texas and Minnesota, which together with the MSA are collectively referred to as the State Settlement Agreements, and the user fees charged by the U.S. Food and Drug Administration, referred to as the FDA. These expenses were as follows:

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2017	**2016**	**2017**	**2016**
State Settlement Agreements	$758	$719	$1,485	$1,349
FDA user fees	46	49	93	99

In 2012, RJR Tobacco, Lorillard Tobacco Company, LLC., referred to as Lorillard Tobacco, SFNTC and certain other participating manufacturers, referred to as the PMs, entered into a term sheet, referred to as the Term Sheet, with 17 states, the District of Columbia and Puerto Rico to settle certain claims related to the MSA non-participating manufacturer adjustment, referred to as the NPM Adjustment. The Term Sheet resolved claims related to volume years from 2003 through 2012 and puts in place a revised method to determine future adjustments from 2013 forward. In 2013 and 2014, five additional states joined the Term Sheet, including two states that were found to not have diligently enforced their qualifying statutes in 2003. An additional two states joined the Term Sheet in the second quarter of 2017 and, as a result, expenses for the MSA were reduced by $17 million for the three and six months ended June 30, 2017. The parties to the Term Sheet represent an allocable share of 51.73%.

As a result of meeting the performance requirements associated with the Term Sheet, RJR Tobacco and Santa Fe, collectively, recognized credits of $16 million and $74 million for the three months ended June 30, 2017 and 2016, respectively, and $26 million and $143 million for the six months ended June 30, 2017 and 2016, respectively. RJR Tobacco expects to recognize additional credits through the remainder of 2017.

In October 2015, RJR Tobacco, SFNTC and certain other PMs entered into a settlement agreement with the State of New York, referred to as the NY Settlement Agreement, to settle certain claims related to the NPM Adjustment. The NY Settlement Agreement resolves NPM Adjustment claims related to payment years from 2004 through 2014, providing RJR Tobacco and SFNTC, collectively, with credits, of approximately $290 million, plus interest, subject to meeting various performance obligations. These credits will be applied against annual payments under the MSA over a four-year period, which commenced with the April 2016 MSA payment. RJR Tobacco and Santa Fe, collectively, recognized credits of $26 million and $24 million as a reduction to costs of products sold for the three months ended June 30, 2017 and 2016, respectively, and $49 million and $46 million for the six months ended June 30, 2017 and 2016, respectively. In addition, the NY Settlement Agreement put in place a new method to determine future adjustments from 2015 forward as to New York.

For additional information related to the NPM Adjustment settlement and the 2003 NPM Adjustment claim, see "— Litigation Affecting the Cigarette Industry — State Settlement Agreements — Enforcement and Validity; Adjustments" in note 7.

Pension and Postretirement

Pension and postretirement benefits require balance sheet recognition of the net asset or net liability position of defined benefit pension and postretirement benefit plans, on a plan-by-plan basis, and recognition of changes in the funded status in the year in which the changes occur.

Actuarial (gains) losses are changes in the amount of either the benefit obligation or the fair value of plan assets resulting from experience different from that assumed or from changes in assumptions. Differences between actual results and actuarial assumptions are accumulated and recognized as a mark-to-market adjustment, referred to as an MTM adjustment, to the extent such accumulated net (gains) losses exceed 10% of the greater of the fair value of plan assets or benefit obligations, referred to as the corridor. Net (gains) losses outside the corridor are generally recognized annually as of December 31, or when a plan is remeasured during an interim period.

Prior service costs (credits) of pension benefits, which are changes in benefit obligations due to plan amendments, are amortized on a straight-line basis over the average remaining service period for active employees, or average remaining life expectancies for inactive employees if most of the plan obligations are due to inactive employees. Prior service costs (credits) of postretirement benefits, which are changes in benefit obligations due to plan amendments, are amortized on a straight-line basis over the expected service period to full eligibility age for active employees, or average remaining life expectancies for inactive employees if most of the plan obligations are due to inactive employees.

The components of the net benefit income are set forth below:

	For the Three Months Ended June 30,				For the Six Months Ended June 30,			
	Pension Benefits		Postretirement Benefits		Pension Benefits		Postretirement Benefits	
	2017	2016	2017	2016	2017	2016	2017	2016
Service cost	$ 5	$ 4	$ 1	$ —	$ 9	$ 8	$ 1	$ 1
Interest cost	67	74	11	11	134	148	22	24
Expected return on plan assets	(97)	(93)	(3)	(2)	(194)	(186)	(5)	(5)
Amortization of prior service cost (credit)	—	—	(9)	(10)	1	1	(18)	(21)
Net benefit income	$(25)	$(15)	$—	$ (1)	$ (50)	$ (29)	$ —	$ (1)

RAI disclosed in its financial statements for the year ended December 31, 2016, that it expects to contribute $111 million to its pension plans in 2017, of which $7 million was contributed during the first six months of 2017.

Fair Value Measurement

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, essentially an exit price. RAI determines the fair value of assets and liabilities using a fair value hierarchy that distinguishes between market participant assumptions based on market data obtained from sources independent of the reporting entity, and the reporting entity's own assumptions about market participant assumptions based on the best information available in the circumstances.

The levels of the fair value hierarchy are:

Level 1: inputs are quoted prices, unadjusted, in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.

Level 2: inputs are other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. A Level 2 input must be observable for substantially the full term of the asset or liability.

Level 3: inputs are unobservable and reflect the reporting entity's own assumptions about the assumptions that market participants would use in pricing the asset or liability.

As of June 30, 2017 and December 31, 2016, the fair value of RAI's cash equivalents was $1.7 billion and $2.0 billion, respectively, and was classified in Level 1 of the fair value hierarchy for both periods. The estimated fair value of RAI's outstanding consolidated debt, in the aggregate, was $14.7 billion and $14.3 billion as of June 30, 2017 and December 31, 2016, respectively. The fair value is derived from a third party pricing source utilizing market quotes, credit spreads and discounted cash flows, as appropriate, and is classified in Level 2 of the fair value hierarchy. Additionally, RAI sponsors a number of non-contributory defined benefit pension plans covering certain employees of RAI and its subsidiaries, and investments in plan assets to fund these obligations are carried at their fair value as of December 31, 2016, and after adjustments for expected returns, cash contributions and benefit payments made in the interim period.

Recently Adopted Accounting Pronouncements

In March 2016, the Financial Accounting Standards Board, referred to as FASB, issued Accounting Standards Update, referred to as ASU, 2016-09, *Compensation — Stock Compensation (Topic 718) — Improvements to Employee Share-Based Payment Accounting*, which simplifies several aspects of the accounting for employee share-based payment transactions, including accounting for income tax, forfeitures, statutory tax withholding requirements, classifications of awards as either equity or liabilities, and classification of taxes in the statement of cash flows. The amended guidance also requires an entity to record excess tax benefits and deficiencies in the income statement rather than as a change to paid-in capital. The amended guidance was effective for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. RAI adopted this amended guidance effective January 1, 2017, on a prospective basis, with no material impact to its results of operations, cash flows and financial position. The adoption resulted in a $29 million decrease to income tax expense for the excess tax benefits and an immaterial increase in potential dilutive weighted average shares for the six months ended June 30, 2017.

Recently Issued Accounting Pronouncements

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers (Topic 606),* which replaces most existing GAAP revenue recognition guidance. The effective date for adoption of this guidance was subsequently deferred to interim and annual reporting periods beginning after December 15, 2017. In 2016, the FASB issued supplemental implementation guidance related to ASU 2014-09, including:

- ASU 2016-08, *Revenue from Contracts with Customers (Topic 606) — Principal versus Agent Considerations (Reporting Revenue Gross versus Net),* which is intended to provide further clarification on the application of the principal versus agent implementation;
- ASU 2016-10, *Revenue from Contracts with Customers (Topic 606) — Identifying Performance Obligations and Licensing*, which is intended to clarify the guidance for identifying promised goods or services in a contract with a customer;
- ASU 2016-11, *Revenue Recognition (Topic 605) and Derivatives and Hedging (Topic 815) — Rescission of SEC Guidance Because of Accounting Standards Updates 2014-09 and 2014-16 Pursuant to Staff Announcements at the March 3, 2016 Emerging Issues Task Force Meeting;*
- ASU 2016-12, *Revenue from Contracts with Customers (Topic 606) — Narrow-Scope Improvements and Practical Expedients*, which amends certain aspects of ASU 2014-09 to address certain implementation issues; and
- ASU 2016-20, *Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers*, which includes 13 technical corrections and improvements affecting narrow aspects of the guidance issued in ASU 2014-09.

During 2016, RAI substantially completed its assessment of ASU 2014-09 to identify any potential changes in the amount and timing of revenue recognition for its current contracts and the expected impact on its business processes, systems and controls. Based on this assessment, RAI does not expect the adoption of ASU 2014-09 to have a material impact on RAI's results of operations, cash flows and financial position. The new guidance may be applied retrospectively to each prior period presented (full retrospective method) or retrospectively with the cumulative effect recognized as of the date of initial application (modified retrospective method). RAI is continuing to evaluate the impact of ASU 2014-09 primarily to determine the transition method to utilize at adoption and the additional disclosures required. The new guidance will be adopted effective January 1, 2018.

In January 2016, the FASB issued ASU 2016-01, *Financial Instruments — Overall (Subtopic 825-10) — Recognition and Measurement of Financial Assets and Liabilities*, which supersedes existing

guidance to classify equity securities with readily determinable fair values into different categories and requires equity securities to be measured at fair value with changes in the fair value recognized through net income. An entity's equity investments that are accounted for under the equity method of accounting or result in consolidation of an investee are not included within the scope of this amended guidance. The amendments allow equity investments that do not have readily determinable fair values to be remeasured at fair value either upon the occurrence of an observable price change or upon identification of impairment. The amended guidance is effective for RAI for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. As permitted, RAI early adopted the application guidance as of January 1, 2017, and will adopt the remaining guidance as of January 1, 2018, with no material impact expected on its results of operations, cash flows and financial position.

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842),* requiring lessees to recognize lease assets and lease liabilities in the balance sheet and disclose key information about leasing arrangements, such as information about variable lease payments and options to renew and terminate leases. The amended guidance will require both operating and finance leases to be recognized in the balance sheet. Additionally, the amended guidance aligns lessor accounting to comparable guidance in Accounting Standard Codification Topic 606, *Revenue from Contracts with Customers.* The amended guidance is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. RAI expects to adopt the amended guidance in ASU 2016-02 effective January 1, 2019, and is currently early in its assessment of the impact of this new standard. However, if at adoption RAI has similar obligations for leases as it had at June 30, 2017, RAI believes this guidance will not have a material impact on its results of operations, cash flows and financial position. RAI expects to substantially complete its assessment of the new standard during 2017.

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments — Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments,* which replaces the current incurred loss impairment methodology for recognizing credit losses for financial instruments with a methodology that reflects expected credit losses and requires consideration for a broader range of reasonable and supportable information for estimating credit losses. The amended guidance is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. Early adoption is permitted for fiscal years beginning after December 15, 2018. RAI has not yet determined if it will adopt this amended guidance earlier than the effective date and has not initiated its assessment of the impact that this guidance will have on its results of operations, cash flows and financial position.

In August 2016, the FASB issued ASU 2016-15, *Statement of Cash Flows (Topic 230) — Classification of Certain Cash Receipts and Cash Payments (a consensus of the FASB Emerging Issues Task Force),* addressing eight specific cash flow issues in an effort to reduce diversity in practice. The amended guidance is effective for fiscal years beginning after December 31, 2017, and for interim periods within those years. RAI will adopt this amended guidance effective January 1, 2018. The amended guidance is not expected to have a material impact on RAI's statements of cash flows.

In November 2016, the FASB issued ASU 2016-18, *Statement of Cash Flows (Topic 230) — Restricted Cash (a consensus of the FASB Emerging Issues Task Force),* addressing the diversity in practice that exists regarding the classification and the presentation of changes in restricted cash on the statement of cash flows. The amended guidance requires that a statement of cash flows explain the change during the period in the total of cash, cash equivalents, restricted cash and restricted cash equivalents. The amended guidance does not provide a definition of restricted cash or restricted cash equivalents. The amended guidance is effective for fiscal years beginning after December 15, 2017, and for interim periods within those years. RAI will adopt this amended guidance effective January 1, 2018. The amended guidance is not expected to have a material impact on RAI's statements of cash flows.

In January 2017, the FASB issued ASU 2017-01, *Business Combinations (Topic 805) — Clarifying the Definition of a Business,* which clarifies the definition of a business and provides guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. The amended guidance is effective for fiscal years beginning after December 15, 2017, including interim periods within those years. RAI will adopt this amended guidance effective January 1, 2018, and the impact of the guidance will be applied prospectively. The amended guidance is not expected to have a material impact on RAI's results of operations, cash flows and financial position.

In January 2017, the FASB issued ASU 2017-04, *Intangibles — Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment,* which simplifies the manner in which an entity tests goodwill for impairment by eliminating Step 2 from the goodwill impairment test. The amended guidance requires that an

entity perform its annual or interim goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount and recognizes an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value; however, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. The amended guidance is effective for annual or interim goodwill impairment tests performed in fiscal years beginning after December 15, 2019. Early adoption is permitted for goodwill impairment tests performed after January 1, 2017. RAI is evaluating the timing of adoption and the effect this guidance will have on its results of operations, cash flows and financial position.

In March 2017, the FASB issued ASU 2017-07, *Compensation — Retirement Benefits (Topic 715) — Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost,* which requires an employer to disaggregate the service cost component from the other components of net benefit (income) cost. The other components of net benefit (income) cost are required to be presented in the income statement separately from the service cost component and outside of operating income. The amendments also allow only the service cost component of net benefit (income) cost to be eligible for capitalization. The amendments in this ASU are effective for fiscal years beginning after December 15, 2017. The amendments in this ASU should be applied (1) retrospectively for the presentation of the service cost component and the other components of net periodic pension (income) cost and net periodic postretirement benefit (income) cost on the income statement, and (2) prospectively, on and after the effective date, for the capitalization of the service cost component of net periodic pension (income) cost and net periodic postretirement benefit (income) cost in assets. RAI is evaluating the effect this guidance will have on its results of operations, cash flows and financial position.

In May 2017, the FASB issued ASU 2017-09, *Compensation — Stock Compensation (Topic 718) — Scope of Modification Accounting,* which amends the scope of modification accounting for share-based payment arrangements and provides guidance on the types of changes to the terms or conditions of share-based payment awards to which an entity would be required to apply modification accounting under Topic 718. The amendments in this ASU are effective for fiscal years beginning after December 15, 2017, including interim periods within those years. Early adoption is permitted, including adoption in any interim period, for reporting periods for which financial statements have not yet been issued. RAI has not yet determined when it will adopt this amended guidance. The amended guidance is not expected to have a material impact on RAI's results of operations, cash flows and financial position.

Note 2 — Intangible Assets

The changes in the carrying amounts of goodwill by segment were as follows:

	RJR Tobacco	Santa Fe	American Snuff	All Other	Consolidated
Balance as of December 31, 2016					
Goodwill	$17,069	$197	$2,501	$16	$19,783
Less: accumulated impairment charges	(3,763)	—	(28)	—	(3,791)
	$13,306	$197	$2,473	$16	$15,992
Balance as of June 30, 2017					
Goodwill	$17,069	$197	$2,501	$16	$19,783
Less: accumulated impairment charges	(3,763)	—	(28)	—	(3,791)
	$13,306	$197	$2,473	$16	$15,992

The carrying amounts and changes therein of trademarks and other intangible assets by segment were as follows:

	RJR Tobacco		Santa Fe	American Snuff	All Other	Consolidated	
	Trademarks	Other	Trademarks	Trademarks	Other	Trademarks	Other
Indefinite-lived:							
Balance as of December 31, 2016	$27,826	$ 87	$136	$1,136	$—	$29,098	$ 87
Balance as of June 30, 2017	$27,826	$ 87	$136	$1,136	$—	$29,098	$ 87
Finite-lived:							
Balance as of December 31, 2016	$ 12	$229	$ —	$ 5	$13	$ 17	$242
Amortization	(3)	(8)	—	—	(1)	(3)	(9)
Balance as of June 30, 2017	$ 9	$221	$ —	$ 5	$12	$ 14	$233

Details of finite-lived intangible assets were as follows:

	June 30, 2017			December 31, 2016		
	Gross	Accumulated Amortization	Net	Gross	Accumulated Amortization	Net
Customer lists	$240	$ (25)	$215	$240	$ (19)	$221
Contract manufacturing agreement	151	(145)	6	151	(143)	8
Trademarks	124	(110)	14	124	(107)	17
Other intangibles	15	(3)	12	15	(2)	13
	$530	$(283)	$247	$530	$(271)	$259

The estimated remaining amortization expense associated with finite-lived intangible assets is expected to be as follows:

Year	Amount
Remainder of 2017	$ 11
2018	22
2019	16
2020	15
2021	14
Thereafter	169
	$247

Note 3 — Income Per Share

The components of the calculation of income per share were as follows:

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2017	2016	2017	2016
Net income	$ 919	$ 796	$ 1,699	$ 4,361
Basic weighted average shares, in thousands	1,426,578	1,427,413	1,426,412	1,427,430
Effect of dilutive potential shares:				
Restricted stock units	2,138	2,554	2,697	3,088
Diluted weighted average shares, in thousands	1,428,716	1,429,967	1,429,109	1,430,518

For additional information regarding dilutive shares, see "— Recently Adopted Accounting Pronouncements" in note 1.

Note 4 — Inventories

The major components of inventories were as follows:

	June 30, 2017	December 31, 2016
Leaf tobacco	$1,222	$1,436
Other raw materials	99	77
Work in process	72	81
Finished products	175	165
Other	23	25
Total	1,591	1,784
LIFO allowance	(143)	(139)
	$1,448	$1,645

RJR Tobacco performs its annual LIFO inventory valuation at December 31. Interim periods represent an estimate of the expected annual valuation.

Note 5 — Income Taxes

The provision for income taxes was as follows:

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2017	2016	2017	2016
Provision for income taxes	$ 479	$ 470	$ 874	$2,624
Effective tax rate	34.3%	37.1%	34.0%	37.6%

The effective tax rate for the six months ended June 30, 2017, was primarily impacted by a $29 million decrease in tax attributable to excess tax benefits on stock-based compensation plans and a reduction in state taxes. The effective tax rate for the six months ended

June 30, 2016, was primarily impacted by an increase in tax attributable to the sale of the international rights to the NATURAL AMERICAN SPIRIT brand name and associated trademarks, along with the international companies that distributed and marketed the brand outside the United States. Additionally, the effective tax rate for each period differed from the federal statutory rate of 35% due to the domestic manufacturing deduction, state income taxes and certain nondeductible items.

Note 6 — Credit Agreement

In December 2014, RAI entered into a credit agreement, referred to as the Credit Agreement, with a syndicate of lenders, providing for a five-year, $2 billion senior unsecured revolving credit facility. The maturity date of the Credit Agreement had been extended to December 18, 2021.

Effective July 25, 2017, RAI terminated the Credit Agreement in connection with the completion of the BAT Merger. For additional information related to the Credit Agreement termination and the BAT Merger, see note 14. The following information is a description of the Credit Agreement prior to its termination on July 25, 2017.

Subject to certain conditions, RAI was able to use the revolving credit facility under the Credit Agreement for borrowings and issuances of letters of credit at its option, subject to a $300 million sublimit on the aggregate amount of letters of credit. Issuances of letters of credit reduced availability under such revolving credit facility.

The Credit Agreement contained certain customary restrictive covenants, and two financial covenants — a consolidated leverage ratio covenant and a consolidated interest coverage ratio covenant. The Credit Agreement contained customary events of default, including upon a change in control, as defined therein, which could result in the acceleration of all amounts outstanding and cancellation of all commitments outstanding under the Credit Agreement.

The lenders' obligations under the Credit Agreement to fund borrowings were subject to the accuracy of RAI's representations and warranties and the absence of any default, provided, however, that the accuracy of RAI's representation as to the absence of any material adverse effect, as defined in the Credit Agreement, was not a condition to borrowing for the purpose of refinancing any maturing commercial paper.

Under the terms of the Credit Agreement, RAI was required to pay a facility fee per annum of between 0.100% and 0.275%, based generally on the ratings of RAI's senior, unsecured, long-term indebtedness, on the lender commitments in respect of the revolving credit facility thereunder.

Borrowings under the Credit Agreement bore interest, at the option of RAI, at a rate equal to an applicable margin based generally on the ratings of RAI's senior, unsecured, long-term indebtedness, plus:

- the alternate base rate — the higher of (1) the federal funds effective rate from time to time plus 0.5%, (2) the prime rate and (3) the reserve adjusted eurodollar rate for a one month interest period plus 1%; or
- the eurodollar rate — the reserve adjusted rate at which eurodollar deposits for one, two, three or six months are offered in the interbank eurodollar market.

Overdue principal outstanding under the revolving credit facility of the Credit Agreement bore interest at a rate equal to the rate then in effect with respect to such borrowings, plus 2.0% per annum. Any amount besides principal that became overdue bore interest at a rate equal to 2.0% per annum in excess of the rate of interest applicable to base rate loans.

Certain of RAI's subsidiaries, including its Material Subsidiaries, as defined in the Credit Agreement, had guaranteed, on an unsecured basis, RAI's obligations under the Credit Agreement. The same subsidiaries that guaranteed the Credit Agreement also guaranteed RAI's outstanding notes. Under the terms of the indenture governing RAI's outstanding notes, if any guarantor of such notes ceased to be a guarantor under the Credit Agreement (or any replacement or refinancing thereof), that guarantor would be released automatically from all of its obligations under the RAI indenture and its guarantee of the RAI notes. In connection with the termination of the Credit Agreement on July 25, 2017, the subsidiary guarantees of the Credit Agreement also terminated. For information regarding the impact of the BAT Merger on the guarantees of RAI's indenture and outstanding notes, see note 14.

In the first six months of 2017, RAI borrowed and repaid $500 million under the Credit Agreement at an interest rate of 2.15%. As of June 30, 2017, there were no outstanding borrowings and no letters of credit outstanding under the Credit Agreement.

Note 7 — Commitments and Contingencies

Tobacco Litigation — General

Introduction

Litigation, claims, and other legal proceedings relating to the use of, exposure to, or purchase of tobacco products are pending or may be instituted in the future against RJR Tobacco (including as successor by merger to Lorillard Tobacco), American Snuff Co., SFNTC, RJR Vapor, RAI, Lorillard, other RAI affiliates, and indemnitees (including but not limited to B&W), sometimes referred to collectively as Reynolds Defendants. These pending legal proceedings include claims relating to cigarette products manufactured by RJR Tobacco, Lorillard Tobacco, SFNTC or certain of their affiliates or indemnitees, smokeless tobacco products manufactured by American Snuff Co., and e-cigarette products manufactured on behalf of and marketed by RJR Vapor. A discussion of the legal proceedings relating to cigarette products (and e-cigarettes) is set forth below under the heading "— Litigation Affecting the Cigarette Industry." All of the references under that heading to tobacco-related litigation, smoking and health litigation and other similar references are references to legal proceedings relating to cigarette products or e-cigarettes, as the case may be, and are not references to legal proceedings involving smokeless tobacco products, and case numbers under that heading include only cases involving cigarette products and e-cigarettes. The legal proceedings relating to the smokeless tobacco products manufactured by American Snuff Co. are discussed separately under the heading "— Smokeless Tobacco Litigation" below.

In connection with the B&W business combination, RJR Tobacco undertook certain indemnification obligations with respect to B&W and its affiliates, including its indirect parent, BAT. As a result of the BAT Merger, these indemnification obligations are now intercompany obligations. See "— Litigation Affecting the Cigarette Industry — Overview — Introduction" below. In connection with the Lorillard Merger and the Divestiture, as applicable, RAI and RJR Tobacco undertook certain indemnification obligations. See "— Litigation Affecting the Cigarette Industry — Overview — Introduction," "— Other Contingencies — ITG Indemnity," and "— Other Contingencies — Loews Indemnity" below. In addition, in connection with the sale of the non-U.S. operations and business of the NATURAL AMERICAN SPIRIT brand, the Sellers have agreed to indemnify the buyer for certain claims. See "— Other Contingencies — JTI Indemnities" below.

Certain Terms and Phrases

Certain terms and phrases used in this footnote may require some explanation. The term "judgment" or "final judgment" refers to the final decision of the court resolving the dispute and determining the rights and obligations of the parties. At the trial court level, for example, a final judgment generally is entered by the court after a jury verdict and after post-verdict motions have been decided. In most cases, the losing party can appeal a verdict only after a final judgment has been entered by the trial court.

The term "damages" refers to the amount of money sought by a plaintiff in a complaint, or awarded to a party by a jury or, in some cases, by a judge. "Compensatory damages" are awarded to compensate the prevailing party for actual losses suffered, if liability is proved. In cases in which there is a finding that a defendant has acted willfully, maliciously or fraudulently, generally based on a higher burden of proof than is required for a finding of liability for compensatory damages, a plaintiff also may be awarded "punitive damages." Although damages may be awarded at the trial court stage, a losing party generally may be protected from paying any damages until all appellate avenues have been exhausted by posting a supersedeas bond. The amount of such a bond is governed by the law of the relevant jurisdiction and generally is set at the amount of damages plus some measure of statutory interest, modified at the discretion of the appropriate court or subject to limits set by a court or statute.

The term "*per curiam*" refers to a decision entered by an appellate court that is not signed by an individual judge. In most cases, it is used to indicate that the opinion entered is a brief announcement of the court's decision and is not accompanied by an opinion explaining the court's reasoning.

The term "settlement" refers to certain types of cases in which cigarette manufacturers, including RJR Tobacco, B&W and Lorillard Tobacco, have agreed to resolve disputes with certain plaintiffs without resolving the cases through trial. The principal terms of certain settlements entered into by RJR Tobacco, B&W and Lorillard Tobacco are explained below under "— Accounting for Tobacco-Related Litigation Contingencies."

Theories of Recovery

The plaintiffs seek recovery on a variety of legal theories, including negligence, strict liability in tort, design defect, failure to warn, fraud, misrepresentation, violations of unfair and deceptive trade practices statutes, conspiracy, medical monitoring and violations of state and federal antitrust laws. In certain of these cases, the plaintiffs claim that cigarette smoking exacerbated injuries caused by exposure to asbestos or, in the case of certain claims asserted against Lorillard Tobacco, that they were injured by exposure to filters containing asbestos used in one cigarette brand for roughly four years before 1957, the latter cases referred to as Filter Cases.

The plaintiffs seek various forms of relief, including compensatory and, where available, punitive damages, treble or multiple damages and statutory damages and penalties, creation of medical monitoring and smoking cessation funds, disgorgement of profits, and injunctive and other equitable relief. Although alleged damages often are not determinable from a complaint, and the law governing the pleading and calculation of damages varies from jurisdiction to jurisdiction, compensatory and punitive damages have been specifically pleaded in a number of cases, sometimes in amounts ranging into the hundreds of millions and even billions of dollars.

Defenses

The defenses raised by Reynolds Defendants include, where applicable and otherwise appropriate, preemption by the Federal Cigarette Labeling and Advertising Act of some or all claims arising after 1969, or by the Comprehensive Smokeless Tobacco Health Education Act for claims arising after 1986, the lack of any defect in the product, assumption of the risk, contributory or comparative fault, lack of proximate cause, remoteness, lack of standing, statutes of limitations or repose and others. RAI, RJR and Lorillard have asserted additional defenses, including jurisdictional defenses, in many of the cases in which they are named.

Accounting for Tobacco-Related Litigation Contingencies

In accordance with GAAP, RAI and its subsidiaries record any loss concerning litigation at such time as an unfavorable outcome becomes probable and the amount can be reasonably estimated on an individual case-by-case basis. For the reasons set forth below, RAI's management continues to conclude that the loss of any particular pending tobacco-related litigation claim against the Reynolds Defendants, when viewed on an individual basis, is not probable, except for certain *Engle* Progeny cases noted below.

Reynolds Defendants believe that they have valid defenses to the tobacco-related litigation claims against them, as well as valid bases for appeal of adverse verdicts against them. Reynolds Defendants have, through their counsel, filed pleadings and memoranda in pending tobacco-related litigation that set forth and discuss a number of grounds and defenses that they and their counsel believe have a valid basis in law and fact. With the exception of the *Engle* Progeny cases described below, Reynolds Defendants continue to win the majority of tobacco-related litigation claims that reach trial, and a very high percentage of the tobacco-related litigation claims brought against them, including *Engle* Progeny cases, continue to be dismissed at or before trial. Based on their experience in tobacco-related litigation and the strength of the defenses available to them in such litigation, Reynolds Defendants believe that their successful defense of tobacco-related litigation in the past will continue in the future.

RAI's condensed consolidated balance sheet (unaudited) as of June 30, 2017, contains accruals for the following *Engle* Progeny cases: *Starr-Blundell, Monroe, Lourie, Lewis, Block* and *Ward* (for attorneys' fees and interest only with respect to *Ward*). In the second quarter of 2017, RJR Tobacco paid approximately $3.5 million in satisfaction of the judgment, including attorneys' fees and interest, in *Lawrence* and attorneys' fees and interest in *Buonomo*. Other accruals include an amount for the estimated costs of the corrective communications in the *U.S. Department of Justice* case. As other cases proceed through the appellate process, RAI will evaluate the need for further accruals on an individual case-by-case basis if an unfavorable outcome becomes probable and the amount can be reasonably estimated.

It is the policy of Reynolds Defendants to defend tobacco-related litigation claims vigorously; generally, Reynolds Defendants and indemnitees do not settle such claims. However, Reynolds Defendants may enter into settlement discussions in some cases, if they believe it is in their best interests to do so. Exceptions to this general approach include, but are not limited to, actions taken pursuant to "offer of judgment" statutes, as described below in "— Litigation Affecting the Cigarette Industry — Overview," and Filter Cases, as described below in "— Litigation Affecting the Cigarette Industry — Filter Cases," as well as other historical examples discussed below.

With respect to smoking and health tobacco litigation claims, the only significant settlements reached by RJR Tobacco, Lorillard Tobacco and B&W involved:

- the State Settlement Agreements and the funding by various tobacco companies of a $5.2 billion trust fund contemplated by the MSA to benefit tobacco growers;
- the original *Broin* flight attendant case discussed below under "— Litigation Affecting the Cigarette Industry — *Broin II* Cases," and
- most of the *Engle* Progeny cases pending in federal court, after the initial docket of over 4,000 such cases was reduced to approximately 400 cases.

The circumstances surrounding the State Settlement Agreements and the funding of a trust fund to benefit the tobacco growers are readily distinguishable from the current categories of tobacco-related litigation claims involving Reynolds Defendants. In the claims underlying the State Settlement Agreements, the states sought to recover funds paid for health care and medical and other assistance to state citizens suffering from diseases and conditions allegedly related to tobacco use. The State Settlement Agreements settled all the health-care cost recovery actions brought by, or on behalf of, the settling jurisdictions and contain releases of various additional present and future claims. In accordance with the MSA, various tobacco companies agreed to fund a $5.2 billion trust fund to be used to address the possible adverse economic impact of the MSA on tobacco growers. A discussion of the State Settlement Agreements, and a table depicting the related payment schedule, is set forth below under "— Litigation Affecting the Cigarette Industry — Health-Care Cost Recovery Cases."

As with claims that were resolved by the State Settlement Agreements, the other cases settled by RJR Tobacco can be distinguished from existing cases pending against the Reynolds Defendants. The original *Broin* case, discussed below under "— Litigation Affecting the Cigarette Industry — *Broin II* Cases," was settled in the middle of trial during negotiations concerning a possible nation-wide settlement of claims similar to those underlying the State Settlement Agreements.

The federal *Engle* Progeny cases likewise presented exceptional circumstances not present in the state *Engle* Progeny cases or elsewhere. All of the federal *Engle* Progeny cases subject to the settlement were pending in the same court, were coordinated by the same judge, and involved the same sets of plaintiffs' lawyers. Moreover, RJR Tobacco settled only after approximately 90% of the federal *Engle* Progeny cases otherwise had been resolved. A discussion of the *Engle* Progeny cases and the settlement of the federal *Engle* Progeny cases is set forth below under "— Litigation Affecting the Cigarette Industry — *Engle* and *Engle* Progeny Cases."

In 2010, RJR Tobacco entered into a comprehensive agreement with the Canadian federal, provincial and territorial governments, which resolved all civil claims related to the movement of contraband tobacco products in Canada during the period 1985 through 1999 that the Canadian governments could assert against RJR Tobacco and its affiliates. These claims involved different theories of recovery than the other tobacco-related litigation claims pending against the Reynolds Defendants.

Also, in 2004, RJR Tobacco and B&W separately settled the antitrust case *DeLoach v. Philip Morris Cos., Inc.,* which was brought by a unique class of plaintiffs: a class of all tobacco growers and tobacco allotment holders. The plaintiffs asserted that the defendants conspired to fix the price of tobacco leaf and to destroy the federal government's tobacco quota and price support program. Despite legal defenses they believed to be valid, RJR Tobacco and B&W separately settled this case to avoid a long and contentious trial with the tobacco growers. The *DeLoach* case involved different types of plaintiffs and different theories of recovery under the antitrust laws than the other tobacco-related litigation claims pending against the Reynolds Defendants.

Finally, as discussed under "— Litigation Affecting the Cigarette Industry — State Settlement Agreements — Enforcement and Validity; Adjustments," RJR Tobacco, B&W and Lorillard Tobacco each has settled certain cases brought by states concerning the enforcement of State Settlement Agreements. Despite legal defenses believed to be valid, these cases were settled to avoid further contentious litigation with the states involved. These enforcement actions involved alleged breaches of State Settlement Agreements based on specific actions taken by particular defendants. Accordingly, any future enforcement actions involving State Settlement Agreements will be reviewed by RJR Tobacco on the merits and should not be affected by the settlement of prior enforcement cases.

Cautionary Statement

Even though RAI's management continues to believe that the loss of particular pending tobacco-related litigation claims against Reynolds Defendants, when viewed on an individual case-by-case basis, is not probable or estimable (except for certain *Engle* Progeny cases described below), the possibility of material losses related to such litigation is more than remote. Litigation is subject to many uncertainties, and generally, it is not possible to predict the outcome of any particular litigation pending against Reynolds Defendants, or to reasonably estimate the amount or range of any possible loss.

Although Reynolds Defendants believe that they have valid bases for appeals of adverse verdicts in their pending cases and valid defenses to all actions and intend to defend them vigorously as described above, it is possible that there could be further adverse developments in pending cases, and that additional cases could be decided unfavorably against Reynolds Defendants. Determinations of liability or adverse rulings in such cases or in similar cases involving other cigarette manufacturers as defendants, even if such judgments are not final, could have a material adverse effect on the litigation against Reynolds Defendants and could encourage the commencement of additional tobacco-related litigation. Reynolds Defendants also may enter into settlement discussions in some cases, if they believe it is in their best interests to do so. In addition, a number of political, legislative, regulatory and other developments relating to the tobacco industry and cigarette smoking have received wide media attention. These developments may negatively affect the outcomes of tobacco-related legal actions and encourage the commencement of additional similar litigation.

Although it is impossible to predict the outcome of such events on pending litigation and the rate new lawsuits may be filed against Reynolds Defendants, a significant increase in litigation or in adverse outcomes for tobacco defendants, or difficulties in obtaining the bonding required to stay execution of judgments on appeal, could have a material adverse effect on any or all of these entities.

Moreover, notwithstanding the quality of defenses available to Reynolds Defendants in litigation matters, it is possible that RAI's results of operations, cash flows or financial position could be materially adversely affected by the ultimate outcome of certain pending litigation or future claims against Reynolds Defendants.

Litigation Affecting the Cigarette Industry

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Overview

Introduction. In connection with the B&W business combination, RJR Tobacco agreed to indemnify B&W and its affiliates against, among other things, certain litigation liabilities, costs and expenses incurred by B&W or its affiliates arising out of the U.S. cigarette and tobacco business of B&W. Also, in connection with the Lorillard Merger, Lorillard Tobacco was merged into RJR Tobacco with RJR Tobacco being the surviving entity, Lorillard Tobacco ceasing to exist, and RJR Tobacco succeeding to Lorillard Tobacco's liabilities, including Lorillard Tobacco's litigation liabilities, costs and expenses, referred to as the Lorillard Tobacco Merger. Although Lorillard Tobacco no longer exists as a result of the Lorillard Tobacco Merger, it will remain as a named party in cases pending on the date of the Lorillard Tobacco Merger until courts grant motions to substitute RJR Tobacco for Lorillard Tobacco or the claims are dismissed. The cases discussed below include cases brought against RJR Tobacco, Lorillard Tobacco and their affiliates and indemnitees, including RAI, RJR, B&W and Lorillard. Cases brought against SFNTC and RJR Vapor also are discussed.

During the second quarter of 2017, 35 tobacco-related cases were served against Reynolds Defendants. On June 30, 2017, there were, subject to the exclusions described immediately below, 249 cases pending against Reynolds Defendants: 232 in the United States and 17 in Canada, as compared with 286 total cases on June 30, 2016. Of the U.S. cases pending on June 30, 2017, 37 are pending in federal court, 194 in state court and one in tribal court, primarily in the following states: Illinois (51 cases); Massachusetts (35 cases); Florida (29 cases); New York (18 cases); Missouri (16 cases); New Mexico (16 cases); and Louisiana (10 cases). The U.S. case number excludes the approximately 564 individual smoker cases pending in West Virginia state court as a consolidated action, 2,694 *Engle* Progeny cases, involving approximately 3,492 individual plaintiffs, and 2,346 *Broin II* cases, pending in the United States against RJR Tobacco, Lorillard Tobacco or certain other Reynolds Defendants.

The following table lists the categories of the U.S. tobacco-related cases pending against Reynolds Defendants as of June 30, 2017, and the increase or decrease from the number of cases pending against Reynolds Defendants as of March 31, 2017, as reported in RAI's Quarterly Report on Form 10-Q for the fiscal quarter ended March 31, 2017, filed with the U.S. Securities and Exchange Commission, referred to as the SEC, on May 3, 2017, and a cross-reference to the discussion of each case type.

Case Type	U.S. Case Numbers as of June 30, 2017	Change in Number of Cases Since March 31, 2017 Increase/ (Decrease)
Individual Smoking and Health Cases	104	(33)
West Virginia IPIC (Number of Plaintiffs) *	1 (approx. 564)	No change
Engle Progeny Cases (Number of Plaintiffs) **	2,694 (approx. 3,492)	(83) (78)
Broin II Cases	2,346	(6)
Class-Action Suits	28	1
Filter Cases	73	(5)
Health-Care Cost Recovery Cases	2	No change
State Settlement Agreements — Enforcement and Validity; Adjustments	2	No change
Other Litigation and Developments	22	(2)

* Includes as one case the approximately 564 cases pending as a consolidated action *In Re: Tobacco Litigation Individual Personal Injury Cases*, sometimes referred to as *West Virginia IPIC* cases, described below. The *West Virginia IPIC* cases have been separated from the Individual Smoking and Health cases for reporting purposes.

** The *Engle* Progeny cases have been separated from the Individual Smoking and Health cases for reporting purposes. The number of cases will fluctuate as cases are dismissed or if any of the dismissed cases are appealed.

The Florida state court class-action case, *Engle v. R. J. Reynolds Tobacco Co.*, and the related cases commonly referred to as *Engle* Progeny cases have attracted significant attention. After the Florida Supreme Court's 2006 ruling that members of the formerly certified class could file individual actions, roughly 10,000 claims or actions were filed in Florida state or federal courts before the deadline set by the Florida Supreme Court. No new or additional such claims may be filed. As reflected in the table above, 2,694 *Engle* Progeny cases were pending as of June 30, 2017, that included claims asserted on behalf of 3,492 plaintiffs. Following an agreement to settle most *Engle* Progeny cases that remained pending in federal courts in the first quarter of 2015, nearly all *Engle* Progeny cases currently pending are in Florida state courts. Since 2009, there have been over 200 *Engle* Progeny trials in Florida state or federal courts involving RJR Tobacco or Lorillard Tobacco. As described more fully immediately below in "— *Scheduled Trials*" and "— *Trial Results*," additional *Engle* Progeny cases involving RJR Tobacco are being tried and set for trial on an ongoing basis. Juries in *Engle* Progeny cases have awarded substantial amounts in compensatory and punitive damage awards, many of which currently are at various stages in the appellate process. RJR Tobacco and Lorillard Tobacco also have paid substantial amounts in compensatory and punitive damage awards in *Engle* Progeny cases. For a detailed description of these cases, see "— *Engle* and *Engle* Progeny cases" below.

In November 1998, the major U.S. cigarette manufacturers, including RJR Tobacco, B&W and Lorillard Tobacco, entered into the MSA with 46 U.S. states, Washington, D.C. and certain U.S. territories and possessions. These cigarette manufacturers previously settled four other cases, brought on behalf of Mississippi, Florida, Texas and Minnesota, by separate agreements with each state. These State Settlement Agreements:

- settled all health-care cost recovery actions brought by, or on behalf of, the settling jurisdictions;
- released the major U.S. cigarette manufacturers from various additional present and potential future claims;
- imposed future payment obligations in perpetuity on RJR Tobacco, B&W, Lorillard Tobacco and other major U.S. cigarette manufacturers; and
- placed significant restrictions on their ability to market and sell cigarettes and smokeless tobacco products.

Payments under the State Settlement Agreements are subject to various adjustments for, among other things, the volume of cigarettes sold, relative market share, operating profit and inflation. See "— Health-Care Cost

Recovery Cases — State Settlement Agreements" below for a detailed discussion of the State Settlement Agreements, including RAI's operating subsidiaries' monetary obligations under these agreements. RJR Tobacco records the allocation of settlement charges as products are shipped.

Scheduled Trials. Trial schedules are subject to change, and many cases are dismissed before trial. There are 32 cases, exclusive of *Engle* Progeny cases, scheduled for trial as of June 30, 2017 through June 30, 2018, for RJR Tobacco, B&W, Lorillard Tobacco or their affiliates and indemnitees: five individual smoking and health cases, 25 Filter Cases, and two other non-smoking and health cases. There are also approximately 117 *Engle* Progeny cases against RJR Tobacco, B&W and/or Lorillard Tobacco set for trial through June 30, 2018. It is not known how many of these cases will actually be tried.

Trial Results. From January 1, 2014 through June 30, 2017, 141 individual smoking and health, *Engle* Progeny, Filter and health-care cost recovery cases in which RJR Tobacco, B&W and/or Lorillard Tobacco were defendants were tried, including ten trials for cases where mistrials were declared in the original proceedings. Verdicts in favor of RJR Tobacco, B&W and Lorillard Tobacco and, in some cases, other defendants, were returned in 67 cases, tried in Florida (41), California (1) and New Jersey (1). There were also 24 mistrials in Florida. Verdicts in favor of the plaintiffs were returned in 65 cases tried in Florida, and one in California. Six cases in Florida were dismissed during trial. One case in Florida was a retrial only as to the amount of damages. In another case in Florida, the jury entered a partial verdict that did not include compensatory or punitive damages, and post-trial motions are pending.

In the second quarter of 2017, eight *Engle* Progeny cases in which RJR Tobacco and/or Lorillard Tobacco was a defendant were tried:

- In *Schlefstein v. R. J. Reynolds Tobacco Co.*, the court declared a mistrial during jury selection.
- In *Lima v. R. J. Reynolds Tobacco Co*., the jury returned a verdict in favor of the plaintiff, found the decedent 40% at fault, RJR Tobacco 60% at fault and the remaining defendant 0% at fault, and awarded $3 million in compensatory damages and $12 million in punitive damages against RJR Tobacco.
- In *Shadd v. R. J. Reynolds Tobacco Co.*, the jury returned a verdict in favor of the plaintiff, found the decedent 95% at fault and RJR Tobacco 5% at fault, and awarded $0 in compensatory damages. Punitive damages were not awarded.
- In *Lawrence v. R. J. Reynolds Tobacco Co.*, the jury returned a verdict in favor of the plaintiff, found the decedent 65% at fault and RJR Tobacco 35% at fault, awarded approximately $858,200 in compensatory damages, and found that the plaintiff was entitled to punitive damages. Prior to the punitive damages phase, the parties resolved the matter.
- In *Sheffield v. R. J. Reynolds Tobacco Co.*, the jury returned a verdict in favor of the plaintiff, found the decedent 40% at fault and RJR Tobacco 60% at fault, awarded $1.8 million in compensatory damages and $5 million in punitive damages.
- In *Olson v. R. J. Reynolds Tobacco Co.*, the court granted RJR Tobacco's motion for a mistrial.
- In *Kogan v. R. J. Reynolds Tobacco Co.*, the jury returned a verdict in favor of RJR Tobacco and the remaining defendant.
- In *Gay v. R. J. Reynolds Tobacco Co.*, a mistrial was granted due to comments made by a prospective juror during jury selection.

In addition, since the end of the second quarter of 2017, two other *Engle* Progeny cases, in which RJR Tobacco, B&W, and/or Lorillard were a defendant were tried:

- In *Maloney v. R. J. Reynolds Tobacco Co.*, the jury returned a verdict in favor of the plaintiff, found the decedent 50% at fault and RJR Tobacco 50% at fault, and awarded $1.65 million in compensatory damages. Punitive damages were not awarded.
- In *Thomas v. R. J. Reynolds Tobacco Co.*, the jury returned a verdict in favor of the plaintiff, found the decedent 45% at fault and RJR Tobacco 55% at fault, and awarded $4 million in compensatory damages. Punitive damages were not awarded.

For a detailed description of the above-described cases, see "— *Engle* and *Engle* Progeny Cases" below.

In the second quarter of 2017, no non-*Engle* Progeny individual smoking and health cases, in which RJR Tobacco, B&W and/or Lorillard Tobacco was a defendant, were tried.

In the second quarter of 2017, no Filter cases, in which RJR Tobacco and/or Lorillard Tobacco was a defendant, were tried.

For information on the verdicts in the *Engle* Progeny cases that have been tried and remain pending as of June 30, 2017, in which verdicts have been returned against RJR Tobacco, Lorillard Tobacco or B&W, or all three, see the *Engle* Progeny cases charts at "— *Engle* and *Engle* Progeny Cases" below. The following chart reflects the verdicts in the non-*Engle* Progeny smoking and health cases, health-care cost recovery cases or Filter Cases that have been tried and remain pending as of June 30, 2017, in which verdicts have been returned against RJR Tobacco, B&W or Lorillard Tobacco, or all three.

Date of Verdict	Case Name/Type	Jurisdiction	Verdict
August 17, 2006	*United States v. Philip Morris USA, Inc.* [Governmental Health- Care Cost Recovery]	U.S. District Court, District of Columbia, (Washington, D.C.)	RJR Tobacco, B&W and Lorillard Tobacco were found liable for civil RICO claims; were enjoined from using certain brand descriptors and from making certain misrepresentations; and were ordered to make corrective communications on five subjects, including smoking and health and addiction, to reimburse the U.S. Department of Justice appropriate costs associated with the lawsuit, and to maintain document web sites.
May 26, 2010	*Izzarelli v. R. J. Reynolds Tobacco Co.* [Individual]	U.S. District Court, District of Connecticut, (Bridgeport, CT)	$13.76 million in compensatory damages; 58% of fault assigned to RJR Tobacco, which reduced the award to $7.98 million against RJR Tobacco; $3.97 million in punitive damages.
September 13, 2013	*DeLisle v. A. W. Chesterton Co.* [Filter]	Circuit Court, Broward County, (Ft. Lauderdale, FL)	$8 million in compensatory damages; 44% of fault assigned to Lorillard Tobacco, which reduced the award to $3.52 million against Lorillard Tobacco.
July 30, 2014	*Major v. Lorillard Tobacco Co.* [Individual]	Superior Court, Los Angeles County, (Los Angeles, CA)	$17.74 million in compensatory damages; 17% of fault assigned to Lorillard Tobacco, which reduced the award to $3.78 million against Lorillard Tobacco.
July 8, 2015	*Larkin v. R. J. Reynolds Tobacco Co.* [Individual]	Circuit Court, Miami-Dade County, (Miami, FL)	$4.96 million in compensatory damages; 62% of fault assigned to RJR Tobacco; $8.5 million in punitive damages. Comparative fault did not apply to the final judgment.

For information on the post-trial status of individual smoking and health cases, the governmental health-care cost recovery case and the Filter Cases, see "— Individual Smoking and Health Cases," "— Health-Care Cost Recovery Cases — U.S. Department of Justice Case," and "— Filter Cases," respectively, below.

Individual Smoking and Health Cases

As of June 30, 2017, 104 individual cases were pending in the United States against RJR Tobacco, B&W (as RJR Tobacco's indemnitee), Lorillard Tobacco or all three. This category of cases includes smoking and health cases alleging personal injuries caused by tobacco use or exposure brought by or on behalf of individual plaintiffs based on theories of negligence, strict liability, breach of express or implied warranty, and violations of state deceptive trade practices or consumer protection statutes. The plaintiffs seek to recover compensatory damages, attorneys' fees and costs, and punitive damages. The category does not include the *Broin II, Engle* Progeny, Filter or *West Virginia IPIC* cases discussed below. One of the individual cases is brought by or on behalf of an individual or his/her survivors alleging personal injury as a result of exposure to environmental tobacco smoke, referred to as ETS.

Below is a description of the non-*Engle* Progeny individual smoking and health cases against RJR Tobacco, B&W, and/or Lorillard Tobacco that went to trial or were decided during the period from January 1, 2017 to June 30, 2017, or remained on appeal as of June 30, 2017.

On May 26, 2010, in *Izzarelli v. R. J. Reynolds Tobacco Co*. (U.S.D.C. D. Conn., filed 1999), the jury awarded the plaintiff $13.76 million in compensatory damages on the negligence and strict liability claims, found RJR Tobacco 58% at fault and the plaintiff 42% at fault, and found that the plaintiff was entitled to punitive damages. The plaintiff sought to recover damages for personal injuries allegedly sustained as a result of unsafe and unreasonably dangerous cigarette products and for economic losses she sustained as a result of supposed unfair trade practices. On December 5, 2010, the district court (1) awarded the plaintiff $3.97 million in punitive damages based on Connecticut's common-law rule limiting punitive damage awards to the amount of litigation expenses less taxable costs, (2) entered judgment in the amount of $11.95 million (the $13.76 million compensatory damages award reduced by the allocation of fault plus the $3.97 million punitive damages award), and (3) granted the plaintiff $15.8 million in offer of judgment interest through that date and, going forward, approximately $4,000 per day until entry of an amended judgment. In March 2011, the district court entered an amended judgment of approximately $28.1 million. RJR Tobacco appealed to the U.S. Court of Appeals for the Second Circuit, referred to as the Second Circuit, and the plaintiff cross appealed. In a non-precedential summary order dated July 7, 2017, the Second Circuit affirmed the $7.98 million compensatory damages award, vacated the $3.97 million punitive damages award, and remanded for a re-determination of punitive damages in light of the Connecticut Supreme Court's decision in the *Bifolck v. Philip Morris, Inc.* case, which ruled that punitive damages in a product liability action are not capped at the amount of litigation expenses less taxable costs under Connecticut's common-law rule, but instead are capped under the Connecticut Product Liability Act at twice the compensatory damages award. RJR Tobacco filed a motion for rehearing and rehearing *en banc* on July 21, 2017. A decision is pending.

On July 30, 2014, in *Major v. Lorillard Tobacco Co.* (Super. Ct. Los Angeles County, Cal., filed 2011), the jury awarded the plaintiff approximately $17.74 million in compensatory damages on the negligence and strict liability claims and found the plaintiff 50% at fault, Lorillard Tobacco 17% at fault, and RJR Tobacco and another manufacturer collectively 33% at fault. Punitive damages were not at issue. RJR Tobacco and the other manufacturer had been dismissed prior to trial. The plaintiffs alleged that as a result of the use of the defendants' products and exposure to asbestos, the decedent, William Major, suffered from lung cancer, and sought an unspecified amount of damages. In August 2014, the trial court entered an initial final judgment of approximately $3.9 million against Lorillard Tobacco. On July 1, 2015, the trial court entered an amended final judgment in the amount of approximately $3.78 million in compensatory damages, approximately $135,000 in costs, approximately $1.9 million in prejudgment interest, and post-judgment interest from August 25, 2014 in the amount of approximately $1,100 per day. Lorillard Tobacco appealed from the original and amended judgments, which appeals have been consolidated, and posted a supersedeas bond in the amount of approximately $9.1 million. On October 20, 2015, the appellate court granted RJR Tobacco's motion to substitute itself for Lorillard Tobacco. Oral argument occurred on June 27, 2017. Before oral argument, the court issued a tentative ruling in which it indicated it was inclined to affirm the judgment. A decision is pending.

On July 8, 2015, in *Larkin v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Miami-Dade County, Fla., filed 2002) the jury awarded the plaintiff approximately $4.96 million in compensatory damages on the strict liability and intentional tort claims, found RJR Tobacco 62% at fault and the decedent 38% at fault, and awarded $8.5 million in punitive damages. The plaintiff alleged that as a result of using the defendant's products, the decedent suffered from mouth and lung cancer, and sought an unspecified amount of compensatory and punitive damages. In July 2015, the trial court entered judgment in the amount of approximately $13.46 million. On March 22, 2016, the trial court granted RJR Tobacco's motion for a new trial on claims of defective product and damages only and denied the remaining post-trial motions. The new trial has not been scheduled. In April 2016, RJR Tobacco appealed to the Third District Court of Appeal, referred to as DCA, and the plaintiff cross appealed. Oral argument occurred on May 3, 2017. On June 28, 2017, the Third DCA affirmed the final judgment and order denying the motion for a new trial as to the fraudulent concealment and conspiracy to conceal claims, reversed the new trial order, and remanded with directions to reinstate the jury verdict. RJR Tobacco filed a motion for clarification and motion for rehearing *en banc* or certification to the Florida Supreme Court on July 13, 2017. A decision is pending.

On February 8, 2016, in *Pooshs v. Philip Morris USA, Inc.* (U.S.D.C. N.D. Cal., filed 2004) the jury returned a verdict in favor of the defendants, including RJR Tobacco. The plaintiff alleged that as a result of using the defendants' products, the plaintiff suffers from lung cancer. Final judgment was entered on February 9,

2016. The plaintiff filed a notice of appeal to the U.S. Court of Appeals for the Ninth Circuit on March 9, 2016. The case has been stayed through September 20, 2017, pending a decision in *Major*, described above.

West Virginia IPIC

In re: Tobacco Litigation Individual Personal Injury Cases (Cir. Ct. Ohio County, W. Va., filed beginning in 1999), is a series of roughly 1,200 individual cases asserting claims against Philip Morris USA Inc., Lorillard Tobacco, RJR Tobacco, B&W and The American Tobacco Company based on alleged personal injuries. The cases were consolidated for a Phase I trial on various defense conduct issues, to be followed in Phase II by individual trials of remaining claims. On May 15, 2013, the Phase I jury found that defendants' cigarettes were not defectively designed; defendants' cigarettes were not defective due to a failure to warn before July 1, 1969; defendants were not negligent, did not breach warranties, and did not engage in conduct warranting punitive damages; and defendants' ventilated filter cigarettes manufactured and sold between 1964 and July 1, 1969 were defective for a failure to instruct. In November 2014, the West Virginia Supreme Court affirmed the verdict. On June 8, 2015, the U.S. Supreme Court denied the plaintiffs' petition for writ of certiorari. On the same date, the trial court issued an order finding that only 30 plaintiffs are alleged to have smoked ventilated filter cigarettes in the relevant period. On October 9, 2015, the trial court outlined the procedures for resolving the claims of the 30 Phase II plaintiffs, which claims will focus on whether plaintiffs blocked cigarette vents and, if so, whether blocking proximately caused their alleged injuries. Five cases were selected to be the first claims tried, and they are tentatively scheduled to be tried beginning in May 2018. In June 2017, the defendants filed a motion to dismiss the failure to instruct claims because the plaintiffs failed to meet the court's deadline to produce experts to support this theory of liability. A decision is pending.

In addition to the foregoing claims, various plaintiffs in 1999 and 2000 asserted claims against retailers and distributors. Those claims were severed and stayed pending the outcome of Phase I. Also, 41 plaintiffs asserted smokeless tobacco claims against various smokeless manufacturers, including 14 claims against certain Reynolds Defendants. Those claims were severed from *IPIC* in 2001, and the plaintiffs took no action to prosecute the claims. They now seek to activate their smokeless claims. On January 25, 2017, the trial court denied the defendants' motion to dismiss those claims as abandoned. The plaintiffs are now free to move forward with their claims.

Engle and Engle Progeny Cases

In July 1998, trial began in *Engle v. R. J. Reynolds Tobacco Co.,* a then-certified class action filed in Circuit Court, Miami-Dade County, Florida, against U.S. cigarette manufacturers, including RJR Tobacco, B&W, Lorillard Tobacco, Philip Morris USA Inc., and others. The then-certified class consisted of Florida citizens and residents, and their survivors, who suffered from smoking-related diseases that first manifested between May 5, 1990, and November 21, 1996, and were caused by an addiction to cigarettes. In July 1999, the jury in Phase I found against RJR Tobacco, B&W, Lorillard Tobacco and the other defendants on common issues relating to the defendants' conduct, general causation, the addictiveness of cigarettes, and entitlement to punitive damages.

On July 14, 2000, the jury in Phase II awarded the class a total of approximately $145 billion in punitive damages, which were apportioned $36.3 billion to RJR Tobacco, $17.6 billion to B&W, and $16.3 billion to Lorillard Tobacco. The defendants appealed.

On December 21, 2006, the Florida Supreme Court prospectively decertified the class and set aside the jury's Phase II punitive damages award. But the court preserved certain of the jury's Phase I findings, including that cigarettes can cause certain diseases, nicotine is addictive, and defendants placed defective cigarettes on the market, breached duties of care, concealed health-related information, and conspired. The court also authorized former class members to file individual lawsuits within one year, and it stated that the preserved findings would have *res judicata* effect in those actions.

In the year after the Florida Supreme Court's *Engle* decision, putative class members filed thousands of individual actions against RJR Tobacco, B&W, Lorillard Tobacco, Philip Morris USA Inc., and the other *Engle* defendants, which actions commonly are referred to as *Engle* Progeny cases. As of June 30, 2017, 2,682 *Engle* Progeny cases were pending in state courts, and 12 *Engle* Progeny cases were pending in federal court against RJR Tobacco, B&W and/or Lorillard Tobacco. Those cases include claims by or on behalf of approximately 3,492 plaintiffs. As of June 30, 2017, RJR Tobacco also was aware of nine additional *Engle* Progeny cases that have been filed but not served. The number of pending cases fluctuates for a variety of reasons, including voluntary and involuntary dismissals. Voluntary dismissals include cases in which a plaintiff accepts an "offer of judgment," referred to in Florida statutes as "proposals for settlement," from RJR Tobacco, Lorillard Tobacco and/or RJR Tobacco's affiliates and indemnitees. An offer of judgment, if rejected by the plaintiff, preserves RJR

Tobacco's and Lorillard Tobacco's right to recover attorneys' fees under Florida law in the event of a verdict favorable to RJR Tobacco or Lorillard Tobacco. Such offers are sometimes made through court-ordered mediations.

At the beginning of the *Engle* Progeny litigation, a central issue was the proper use of the preserved *Engle* findings. RJR Tobacco has argued that use of the *Engle* findings to establish individual elements of progeny claims (such as defect, negligence and concealment) is a violation of federal due process. In 2013, however, both the Florida Supreme Court and the U.S. Court of Appeals for the Eleventh Circuit, referred to as the Eleventh Circuit, rejected that argument. As noted below, the Eleventh Circuit, this time sitting *en banc*, recently heard argument on this issue again. In addition to this global due process argument, RJR Tobacco and Lorillard Tobacco raise many other factual and legal defenses as appropriate in each case. These defenses may include, among other things, arguing that the plaintiff is not a proper member of the *Engle* class, that the plaintiff did not rely on any statements by any tobacco company, that the trial was conducted unfairly, that some or all claims are preempted or barred by applicable statutes of limitation, or that any injury was caused by the smoker's own conduct. In *Hess v. Philip Morris USA Inc.* and *Russo v. Philip Morris USA Inc.*, decided on April 2, 2015, the Florida Supreme Court held that, in *Engle* Progeny cases, the defendants cannot raise a statute of repose defense to claims for concealment or conspiracy. On April 8, 2015, in *Graham v. R. J. Reynolds Tobacco Co.*, the Eleventh Circuit held that federal law impliedly preempts use of the preserved *Engle* findings to establish claims for strict liability or negligence. On January 21, 2016, the Eleventh Circuit granted the plaintiff's motion for rehearing *en banc* and vacated the panel decision. On May 18, 2017, the *en banc* Eleventh Circuit rejected RJR Tobacco's due process and implied preemption arguments. On January 6, 2016, in *Marotta v. R. J. Reynolds Tobacco Co.*, the Fourth DCA disagreed with the *Graham* panel decision and held that federal law does not impliedly preempt any tort claims against cigarette manufacturers, including those of *Engle* Progeny plaintiffs. The Florida Supreme Court accepted jurisdiction in *Marotta,* heard oral argument, and on April 6, 2017, found that federal law does not preempt the *Engle* Progeny plaintiff's claims and remanded for further proceedings on punitive damages.

In June 2009, Florida amended its existing bond cap statute by adding a $200 million bond cap that applied to all *Engle* Progeny cases in the aggregate. In May 2011, Florida removed the provision that would have allowed the bond cap to expire on December 31, 2012. The bond cap for any given individual *Engle* Progeny case varies depending on the number of judgments on appeal at a given time, but never exceeds $5 million per case for appeals within the Florida state court system. The legislation, which became effective in June 2009 and 2011, applied to judgments entered after the original 2009 effective date.

During 2015, RJR Tobacco and Lorillard Tobacco, together with Philip Morris USA Inc., settled virtually all of the *Engle* Progeny cases then pending against them in federal district court. The total amount of the settlement was $100 million divided as follows: RJR Tobacco — $42.5 million; Philip Morris USA Inc. — $42.5 million; and Lorillard Tobacco — $15 million. The settlement covered more than 400 federal progeny cases but did not cover 12 federal progeny cases previously tried to verdict and currently pending on post-trial motions or appeal; and 2 federal progeny cases filed by different lawyers from the ones who negotiated the settlement for the plaintiffs. Between August 3, 2015 and January 4, 2016, RJR Tobacco and Philip Morris USA Inc. removed 39 *Engle* Progeny cases from state to federal courts in Florida. These cases were not part of the settlement described above and were all remanded back to state court.

One hundred thirty-seven *Engle* Progeny cases have been tried in Florida state and federal courts since the beginning of 2014 through June 30, 2017, and additional state court trials are scheduled for 2017 and 2018. Since the beginning of 2014 through June 30, 2017, RJR Tobacco or Lorillard Tobacco has paid judgments in 39 *Engle* Progeny cases. Those payments totaled $344.1 million and included $246.3 million for compensatory or punitive damages and $97.8 million for attorneys' fees and statutory interest. In addition, accruals for damages and attorneys' fees and statutory interest for *Starr-Blundell, Monroe, Lourie, Lewis,* and *Block* and an accrual for attorneys' fees and interest for *Ward* were recorded in RAI's condensed consolidated balance sheet (unaudited) as of June 30, 2017. The following chart reflects the details of accrued compensatory damages related to *Starr-Blundell, Monroe, Lourie, Lewis* and *Block.*

Plaintiff Case Name	RJR Tobacco Allocation of Fault	Lorillard Tobacco Allocation of Fault	Compensatory Damages (as adjusted) (1)	Punitive Damages	Appeal Status
Starr-Blundell . . .	10%	—	$ 50,000	$ —	First DCA, *per curiam*, reversed and remanded its May 29, 2015 opinion to the trial court for reconsideration in light of the decision in *Soffer;* retrial limited to punitive damages on the plaintiff's non-intentional tort claims is scheduled for February 2018
Monroe	58%	—	6,380,000	—	First DCA affirmed the final judgment, *per curiam*, on March 23, 2017; Florida Supreme Court declined to accept jurisdiction on June 13, 2017; deadline to file petition for writ of certiorari with the U.S. Supreme Court is September 11, 2017
Lourie	3%	7%	137,000	—	Second DCA affirmed the final judgment; Florida Supreme Court declined to accept jurisdiction based on their decision in *Marotta*; deadline to file a petition for writ of certiorari with the U.S. Supreme Court is September 18, 2017
Lewis	25%	—	187,500	—	Fifth DCA affirmed the final judgment, *per curiam*, on May 2, 2017; deadline to file a petition for writ of certiorari with the U.S. Supreme Court is September 29, 2017
Block	50%	—	463,000	800,000	Fourth DCA affirmed the final judgment, *per curiam*, on April 27, 2017; deadline to file a petition for writ of certiorari with the U.S. Supreme Court is September 22, 2017
Totals			$ 7,217,500	$800,000	

(1) Compensatory damages are adjusted to reflect the reduction that may be required by the allocation of fault. Punitive damages are not adjusted and reflect the amount of the final judgment(s) signed by the trial court judge(s). The amount listed above does not include attorneys' fees or statutory interest of approximately $3.6 million in *Starr-Blundell, Monroe, Lourie, Lewis* and *Block* or approximately $1.6 million in attorneys' fees and statutory interest in *Ward.*

The following chart lists judgments in all other individual *Engle* Progeny cases pending as of June 30, 2017, in which a verdict or judgment has been returned against RJR Tobacco, B&W, and/or Lorillard Tobacco and the verdict or judgment has not been set aside on appeal. No liability for any of these cases has been recorded in RAI's condensed consolidated balance sheet (unaudited) as of June 30, 2017. This chart does not include the mistrials or verdicts returned in favor of RJR Tobacco, B&W, and/or Lorillard Tobacco.

Plaintiff Case Name	RJR Tobacco Allocation of Fault	Lorillard Tobacco Allocation of Fault	Compensatory Damages (as adjusted) (1)	Punitive Damages	Appeal Status
Putney	30%	—	$ —	$2,500,000	Fourth DCA reinstated the punitive damages awards of $2.5 million each against RJR Tobacco and the remaining defendant; court's opinion that previously granted remittitur of the compensatory damages awards still stands; remanded to trial court for further proceedings
Andy Allen	24%	—	2,475,000	7,756,000	First DCA affirmed the judgment of the trial court; First DCA granted defendants' motion for rehearing *en banc* on June 15, 2017, and ordered further briefing
Calloway	27%	18%	—	—	Fourth DCA granted rehearing *en banc* and substituted a new opinion ordering a new trial based on improper argument; plaintiff filed a petition for writ of certiorari with the U.S. Supreme Court on June 14, 2017; a new trial date has not been scheduled
James Smith	55%	—	600,000 (2)	20,000	Pending – Eleventh Circuit
Evers	60%	9%	2,950,000	12,360,000	Second DCA reinstated punitive damage award of $12.36 million the trial court had set aside; the verdict was reinstated on remand; a subsequent appeal is pending in the Second DCA; oral argument occurred on February 7, 2017; decision is pending
Schoeff	75%	—	7,875,000	—	Pending – Florida Supreme Court
Marotta	58%	—	3,480,000	—	Florida Supreme Court found that federal law does not preempt the plaintiff's claims; remanded for further proceedings regarding punitive damages; trial has been scheduled for the July 4, 2018 through September 28, 2018 trial calendar
Searcy	30%	—	500,000 (2)	1,670,000	Pending – Eleventh Circuit
Earl Graham	20%	—	550,000	—	Eleventh Circuit, sitting *en banc*, rejected the defendants' due process and implied preemption claims with dissents; deadline to file a petition for writ of certiorari with the U.S. Supreme Court is September 15, 2017

Plaintiff Case Name	RJR Tobacco Allocation of Fault	Lorillard Tobacco Allocation of Fault	Compensatory Damages (as adjusted) (1)	Punitive Damages	Appeal Status
Grossman	75%	—	11,514,000	22,500,000	Fourth DCA ordered award of compensatory damages reduced to reflect comparative fault, but otherwise affirmed; RJR Tobacco's motion for rehearing was denied on March 16, 2017; plaintiff and RJR Tobacco filed notices to invoke the discretionary jurisdiction of the Florida Supreme Court; decision is pending
Burkhart	25%	10%	3,500,000 (2)	1,750,000	Pending – Eleventh Circuit
Bakst (Odom)	75%	—	—	—	Fourth DCA reversed the judgment of the trial court and remanded the case for a new trial on damages only; motion for rehearing was denied on February 27, 2017; the plaintiff filed a notice to invoke the discretionary jurisdiction of the Florida Supreme Court on March 27, 2017; decision is pending
Robinson	71%	—	—	—	First DCA reversed judgment and remanded case for a new trial and denied rehearing; new trial has not been scheduled; on June 14, 2017, the plaintiff filed a notice to invoke the discretionary jurisdiction of the Florida Supreme Court; decision is pending
Harris	15%	10%	1,100,000 (2)	—	Post-trial motions are pending (3)
Irimi	14.5%	14.5%	—	—	Pending – Fourth DCA
Kerrivan	31%	—	6,046,660 (2)	9,600,000	Post-trial motions are pending (3)
Schleider	70%	—	14,700,000	—	Pending – Third DCA
Perrotto	20%	6%	1,063,000	—	Plaintiff's motion for a new trial granted as to punitive damages; new trial scheduled for December 1, 2017
Ellen Gray	50%	—	3,000,000	—	Post-trial motions are pending (3)
Sowers	50%	—	2,125,000	—	Post-trial motions are pending (3)
Caprio	20%	10%	167,700	—	New trial scheduled for August 9, 2017
Zamboni	30%	—	102,000	—	Final judgment has not been entered
Pollari	42.5%	—	4,250,000	1,500,000	Pending – Fourth DCA
Gore	23%	—	460,000	—	Pending – Fourth DCA
Ryan	65%	—	13,975,000	25,000,000	Pending – Fourth DCA
Hardin	13%	—	100,880	—	Third DCA remanded the case for a new trial on punitive damages for the non-intentional tort claims; new trial is scheduled to begin August 21, 2017
McCoy	25%	20%	670,000	6,000,000	Pending – Fourth DCA
Cooper	40%	—	1,200,000	—	Pending – Fourth DCA
Duignan	30%	—	2,690,000 (2)	2,500,000	Pending – Second DCA
O'Hara	85%	—	14,700,000	20,000,000	Pending – First DCA

Notes to Condensed Consolidated Financial Statements (Unaudited) (Continued)

Plaintiff Case Name	RJR Tobacco Allocation of Fault	Lorillard Tobacco Allocation of Fault	Compensatory Damages (as adjusted) (1)	Punitive Damages	Appeal Status
Marchese	22.5%	—	225,000	250,000	Pending – Fourth DCA
Barbose	42.5%	—	5,000,000 (2)	500,000	Pending – Second DCA
Ledoux	47%	—	5,000,000 (2)	12,500,000	Pending – Third DCA
Ewing	2%	—	4,800	—	Post-trial motions denied; final judgment has not been entered
Ahrens	44%	—	5,800,000 (2)	2,500,000	Second DCA affirmed the final judgment, *per curiam*; defendants' motion for a written opinion granted; new opinion substituted; deadline for the defendants to file a notice to invoke the discretionary jurisdiction of the Florida Supreme Court is August 11, 2017
Turner	80%	—	2,400,000	10,000,000	Pending – Fourth DCA
Enochs	66%	—	13,860,000	6,250,000	Pending – Fourth DCA
Dion	75%	—	12,000,000 (2)	30,000	Pending – Second DCA
Nally	75%	—	6,000,000 (2)	12,000,000	Pending – Second DCA
McCabe	30%	—	1,500,000	6,500,000	Pending – Second DCA
Sermons	5%	—	3,250	17,075	Post-trial motions are pending (3)
Mathis	55%	—	5,000,000 (2)	—	Pending – Third DCA
Oshinsky-Blacker	25%	—	—	—	Pending – Fourth DCA
Sherry Smith	65%	—	3,000,000 (2)	—	Pending – Fifth DCA
Prentice	40%	—	2,560,000	—	Pending – First DCA
Konzelman	85%	—	7,476,000	20,000,000	Pending – Fourth DCA
Ledo	49%	—	2,940,000	—	Post-trial motions are pending (3)
Johnston	90%	—	6,750,000	14,000,000	Pending – Second DCA
Howles	50%	—	2,000,000	3,000,000	Pending – Fourth DCA
Ford	15%	—	153,400	—	Pending – Fourth DCA
Martin	22%	—	1,190,400	200,000	Pending – Fourth DCA
Pardue	50%	—	3,467,000 (2)	6,750,000	Pending – First DCA
John Brown	35%	—	2,700,000 (2)	200,000	Post-trial motions are pending (3)
Fox	50%	—	3,000,000	—	Post-trial motions denied; RJR Tobacco filed a notice of appeal to the Fourth DCA on July 24, 2017
Whitmire	67%	—	3,000,000 (2)	—	Pending – First DCA
Santoro	26%	—	417,000	90,000	Post-trial motions are pending (3)
Lima	60%	—	1,800,000	12,000,000	Post-trial motions are pending (3)
Sheffield	60%	—	1,800,000 (2)	5,000,000	Post-trial motions denied and final judgment entered against RJR Tobacco in the amount of $1.8 million in compensatory damages and $5 million in punitive damages; deadline for RJR Tobacco to file a notice of appeal to the Fifth DCA is August 9, 2017
Maloney	50%	—	1,650,000 (2)	—	Post-trial motions are pending (3)
Thomas	55%	—	2,200,000	—	Post-trial motions are pending (3)
Totals			$ 202,691,090	$224,943,075	

(1) Unless otherwise noted, compensatory damages in these cases are adjusted to reflect the jury's allocation of comparative fault. Punitive damages are not so adjusted. The amounts listed above do not include attorneys' fees or statutory interest that may apply to the judgments and such fees and interest may be material.

(2) The court did not apply comparative fault in the final judgment.

(3) Should the pending post-trial motions be denied, RJR Tobacco will likely file a notice of appeal with the appropriate appellate court.

As reflected in the preceding chart, as of June 30, 2017, verdicts or judgments in favor of *Engle* Progeny plaintiffs have been entered and remain outstanding against RJR Tobacco or Lorillard Tobacco totaling $202,691,090 in compensatory damages (as adjusted) and $224,943,075 in punitive damages, which is a combined total of $427,634,165. These verdicts or judgments are at various stages in the post-trial or appellate process. RJR Tobacco believes that RJR Tobacco and Lorillard Tobacco have valid defenses in these cases, including case-specific issues beyond the due process issue discussed above, and, as described in more detail above in "— Accounting for Tobacco-Related Litigation Contingencies," RJR Tobacco and its affiliates vigorously defend smoking and health claims, including *Engle* Progeny cases.

Should RJR Tobacco or Lorillard Tobacco not prevail in any particular individual *Engle* Progeny case or determine that in any individual *Engle* Progeny case an unfavorable outcome has become probable and the amount can be reasonably estimated, a loss would be recognized, which could have a material adverse effect on the results of operations, cash flows and financial position of RAI. This position on loss recognition for *Engle* Progeny cases as of June 30, 2017, is consistent with RAI's and RJR Tobacco's historic position on loss recognition for other smoking and health litigation. It is the policy of RJR Tobacco to record any loss concerning litigation at such time as an unfavorable outcome becomes probable and the amount can be reasonably estimated on an individual case-by-case basis.

Below is a description of the *Engle* Progeny cases against RJR Tobacco, B&W, and/or Lorillard Tobacco that went to trial or were decided during the period from January 1, 2017 to June 30, 2017, or remained on appeal as of June 30, 2017, listed chronologically by the date of the verdict. In each case, the plaintiff: (1) alleged that the smoker was addicted to nicotine in cigarettes and, as a result of that addiction, suffered or died from one or more smoking-related diseases; (2) asserted claims based on theories of negligence, strict liability, and intentional tort; and (3) sought to recover unspecified compensatory damages, as well as attorneys' fees and costs. The plaintiffs in most, but not all, cases also sought to recover punitive damages.

On April 13, 2010, in *Putney v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Broward County, Fla., filed 2007), a jury in Phase I of the trial returned a verdict for the plaintiff. On April 26, 2010, the jury in Phase II of the trial found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $15.1 million in compensatory damages; found the decedent 35% at fault, RJR Tobacco 30% at fault and the remaining defendants collectively 35% at fault; and awarded $2.5 million in punitive damages against each of RJR Tobacco and one of the remaining defendants. In August 2010, the trial court entered final judgment against RJR Tobacco in the amount of $4.5 million in compensatory damages and $2.5 million in punitive damages. In December 2010, the trial court entered an amended final judgment to provide that interest would run from April 26, 2010. In June 2013, the Fourth DCA held that the trial court erred in denying the defendants' motion for remittitur of the compensatory damages for loss of consortium and in striking the defendants' statute of repose affirmative defenses. As a result, the Fourth DCA reversed and remanded for further proceedings. After its April 2, 2015, ruling in *Hess v. Philip Morris USA Inc.* that *Engle* Progeny defendants cannot raise a statute of repose defense to claims for concealment or conspiracy, the Florida Supreme Court, on February 1, 2016, accepted jurisdiction in *Putney*, quashed the Fourth DCA's decision and reinstated the verdict. On March 15, 2016, the Florida Supreme Court granted the defendants' motion for clarification in an order stating that remand was for reconsideration only on the issue of the statute of repose. On August 31, 2016, the Fourth DCA entered a new opinion following remand from the Florida Supreme Court. The court reinstated the punitive damages awards of $2.5 million each against RJR Tobacco and the remaining defendant. The court's opinion that previously granted remittitur of the compensatory damages awards still stands. The matter has been remanded to the trial court for further proceedings.

On April 21, 2010, in *Grossman v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Broward County, Fla., filed 2007), the jury, in Phase I of a retrial that followed a mistrial, returned a verdict for the plaintiff. On April 29, 2010, the jury in Phase II of the retrial found for the plaintiff on the strict liability claim and for RJR Tobacco on the negligence, warranty, and intentional tort claims; awarded $1.9 million in compensatory damages; found RJR Tobacco 25% at fault, the decedent 70% at fault, and the decedent's spouse 5% at fault; and did not reach the issue of entitlement to punitive damages. In June 2010, the trial court entered final judgment against RJR Tobacco in the amount of approximately $484,000 in compensatory damages. In June 2012, the Fourth DCA affirmed the trial court's judgment, but remanded for a new trial on all Phase II issues. On July 31, 2013, the jury in the second retrial found for the plaintiff on the intentional tort claims, awarded $15.35 million in compensatory damages, found the decedent 25% at fault and RJR Tobacco 75% at fault, and awarded $22.5 million in punitive damages. The trial court entered final judgment in August 2013 and did not include a reduction for comparative fault. RJR Tobacco appealed, and the plaintiff cross appealed. On January 4, 2017, the Fourth DCA ordered the award of compensatory damages be reduced to reflect the comparative fault allocation

assigned by the jury, but otherwise affirmed the final judgment. RJR Tobacco's motion for rehearing was denied on March 16, 2017. The plaintiff filed a notice to invoke the discretionary jurisdiction of the Florida Supreme Court on April 13, 2017. RJR Tobacco filed a notice to invoke the discretionary jurisdiction of the Florida Supreme Court on April 14, 2017. In orders dated April 19, 2017, and April 21, 2017, the Florida Supreme Court stayed those matters pending the resolution of *Schoeff*, described below. On May 11, 2017, the Florida Supreme Court lifted the stay as to RJR Tobacco's notice to invoke the court's jurisdiction. Jurisdictional briefing is complete, and a decision is pending.

On April 26, 2011, in *Andy Allen v. R. J. Reynolds Tobacco Co*. (Cir. Ct. Duval County, Fla., filed 2007), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $6 million in compensatory damages; found RJR Tobacco 45% at fault, the decedent 40% at fault, and the remaining defendant 15% at fault; and awarded $17 million in punitive damages against each defendant. The trial court entered final judgment against RJR Tobacco in the amount of $19.7 million in May 2011 and, in October 2011, entered a remittitur of the punitive damages to $8.1 million. In May 2013, the First DCA reversed and remanded the case for a new trial. On November 24, 2014, the jury in the retrial found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $3.1 million in compensatory damages; found the decedent 70% at fault, RJR Tobacco 24% at fault, and the remaining defendant to be 6% at fault; and found that the plaintiff was entitled to punitive damages. On November 26, 2014, the jury awarded approximately $7.75 million in punitive damages against each defendant. In August 2015, the trial court entered final judgment against RJR Tobacco and the remaining defendant, jointly and severally, in the amount of approximately $3.1 million in compensatory damages and $7.75 million in punitive damages from each defendant. In September 2015, the defendants filed a notice of appeal to the First DCA. On February 24, 2017, the First DCA affirmed the judgment of the trial court. The court granted the defendants' motion for rehearing *en banc* on June 15, 2017. Supplemental briefing is underway.

On May 17, 2012, in *Calloway v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Broward County, Fla., filed 2007), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $20.5 million in compensatory damages; found the decedent 20.5% at fault, RJR Tobacco 27% at fault, Lorillard Tobacco 18% at fault, and the remaining defendants collectively 34.5% at fault; and found that the plaintiff was entitled to punitive damages. On May 31, 2012, the jury awarded punitive damages in the amount of $17.25 million against RJR Tobacco, $12.6 million against Lorillard Tobacco, and $25 million collectively against the remaining defendants. The trial court later determined that the jury's apportionment of comparative fault did not apply to the compensatory damages award and, in August 2012, entered final judgment. On January 6, 2016, the Fourth DCA reversed the fraudulent concealment and conspiracy claims, reversed the punitive damages award, and remanded the case for a new trial on those issues. On September 23, 2016, the Fourth DCA, sitting *en banc,* reversed the judgment in its entirety and remanded the case for a new trial. On March 16, 2017, the Florida Supreme Court declined to accept jurisdiction of the case. The new trial has not been scheduled. On June 14, 2017, the plaintiff filed a petition for writ of certiorari with the U.S. Supreme Court. A decision is pending.

On October 17, 2012, in *James Smith v. R. J. Reynolds Tobacco Co*. (U.S.D.C. M.D. Fla., filed 2007), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $600,000 in compensatory damages; found the decedent 45% at fault and RJR Tobacco 55% at fault; and found that the plaintiff was entitled to punitive damages. On October 18, 2012, the jury awarded $20,000 in punitive damages. The trial court entered final judgment against RJR Tobacco in the amount of $620,000. RJR Tobacco appealed to the Eleventh Circuit and posted a supersedeas bond in the amount of approximately $620,000. Oral argument occurred on October 17, 2014. A decision is pending.

On February 11, 2013, in *Evers v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Hillsborough County, Fla., filed 2007), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $3.23 million in compensatory damages; found the decedent 31% at fault, RJR Tobacco 60% at fault and Lorillard Tobacco 9% at fault; and found that the plaintiff was entitled to punitive damages from RJR Tobacco but not from Lorillard Tobacco. On February 12, 2013, the jury awarded $12.36 million in punitive damages against RJR Tobacco. In March 2013, the trial court granted the defendants' post-trial motions for directed verdict on fraudulent concealment, conspiracy and punitive damages and set aside the $12.36 million punitive damages award. The trial court entered final judgment in the amount of $1.77 million against RJR Tobacco and approximately $266,000 against Lorillard Tobacco. On November 6, 2015, the Second DCA concluded that the trial court erred in granting the defendants' motion for directed verdict on claims for fraud by concealment and conspiracy to commit fraud by concealment, and reversed and reinstated the jury's verdict on those two claims. As a result, the punitive damages award was reinstated. On remand, the jury's verdict was reinstated. On March 14, 2016, the trial court entered an amended final judgment against RJR Tobacco in the amount of

$2.95 million in compensatory damages and $12.36 million in punitive damages. In April 2016, RJR Tobacco appealed to the Second DCA and posted a supersedeas bond in the amount of $5 million. Oral argument occurred on February 7, 2017. A decision is pending.

On February 13, 2013, in *Schoeff v. R. J. Reynolds Tobacco Co*. (Cir. Ct. Broward County, Fla., filed 2007), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $10.5 million in compensatory damages; found the decedent 25% at fault and RJR Tobacco 75% at fault; and found that the plaintiff was entitled to punitive damages. On February 14, 2013, the jury awarded $30 million in punitive damages. In April 2013, the trial court entered final judgment against RJR Tobacco in the amount of $7.88 million in compensatory damages and $30 million in punitive damages. On November 4, 2015, the Fourth DCA reversed the punitive damages portion of the final judgment and remanded the case to the trial court, directing the trial court to grant RJR Tobacco's motion for remittitur and, if RJR Tobacco does not agree with the remitted amount, to hold a new trial on punitive damages. On May 26, 2016, the Florida Supreme Court accepted jurisdiction of the case. Oral argument occurred on March 8, 2017. A decision is pending.

On March 20, 2013, in *Marotta v. R. J. Reynolds Tobacco Co*. (Cir. Ct. Broward County, Fla., filed 2007), the jury, in a retrial following a mistrial, found for the plaintiff on the strict liability claim and for RJR Tobacco on the negligence and intentional tort claims, awarded $6 million in compensatory damages, found the decedent 42% at fault and RJR Tobacco 58% at fault, and did not reach the issue of entitlement to punitive damages. The trial court later entered final judgment against RJR Tobacco in the amount of $3.48 million. On January 6, 2016, the Fourth DCA affirmed, disagreeing with the Eleventh Circuit panel decision in *Graham*, discussed below, regarding whether federal law preempts the plaintiff's claims. The Fourth DCA also certified a question presenting the preemption issue to the Florida Supreme Court. On March 8, 2016, the Florida Supreme Court accepted jurisdiction of the case. On April 6, 2017, the Florida Supreme Court rephrased the certified question and then found that federal law does not preempt the plaintiff's claims. The Florida Supreme Court then remanded the case to the Fourth DCA for further proceedings regarding punitive damages in light of its decision in *Soffer*. On May 2, 2017, the Fourth DCA remanded the case to the trial court for a trial on punitive damages. The trial has been scheduled for the July 4, 2018 through September 28, 2018 trial calendar.

On April 1, 2013, in *Searcy v. R. J. Reynolds Tobacco Co*. (U.S.D.C. M.D. Fla., filed 2008), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $6 million in compensatory damages; found the decedent 40% at fault, RJR Tobacco 30% at fault and the remaining defendant 30% at fault; and awarded $10 million in punitive damages against each defendant. The trial court later entered final judgment against RJR Tobacco in the amount of $6 million in compensatory damages and $10 million in punitive damages. In September 2013, the trial court granted the defendants' motion for a new trial, or in the alternative, reduction or remittitur of the damages awarded to the extent it sought remittitur of the damages. The compensatory damage award was remitted to $1 million, and the punitive damage award was remitted to $1.67 million against each defendant. The plaintiff filed a notice of acceptance of remittitur in November 2013, and the trial court issued an amended final judgment. The defendants appealed to the Eleventh Circuit, and RJR Tobacco posted a supersedeas bond in the amount of approximately $2.2 million. Oral argument occurred on October 17, 2014. The court ordered the parties to file supplemental briefs addressing the impact of *Graham*, described below. Briefs have been submitted, and a decision is pending.

On May 2, 2013, in *David Cohen v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Palm Beach County, Fla., filed 2007), a jury found for the plaintiff on the negligence and strict liability claims and for the defendants on the intentional tort claims; awarded $2.06 million in compensatory damages; found the decedent 40% at fault, RJR Tobacco 30% at fault, Lorillard Tobacco 20% at fault and the remaining defendant 10% at fault; and did not reach the issue of entitlement to punitive damages. In May 2013, the trial court entered final judgment against RJR Tobacco in the amount of $617,000 and against Lorillard Tobacco in the amount of approximately $411,000. In July 2013, the court granted the defendants' motion for a new trial due to the plaintiff's improper arguments during closing. The new trial date has not been scheduled. The plaintiff filed a notice of appeal to the Fourth DCA, and the defendants filed a notice of cross appeal. On September 7, 2016, the Fourth DCA affirmed the trial court's order granting RJR Tobacco's motion for a new trial. The Florida Supreme Court declined to accept jurisdiction of the case on March 16, 2017. The plaintiff did not seek further review.

On May 23, 2013, in *Earl Graham v. R. J. Reynolds Tobacco Co.* (U.S.D.C. M.D. Fla., filed 2008), a jury found for the plaintiff on the negligence and strict liability claims and for the defendants on the intentional tort claims; awarded $2.75 million in compensatory damages; found the decedent 70% at fault, RJR Tobacco 20% at fault, and the remaining defendant 10% at fault, and did not reach the issue of entitlement to punitive damages. In May 2013, the trial court entered final judgment against RJR Tobacco in the amount of $550,000. On April 8,

2015, the Eleventh Circuit reversed and ordered entry of judgment for RJR Tobacco. The Eleventh Circuit held that federal law impliedly preempts claims for strict liability and negligence based on the defect and negligence findings from *Engle*.

On January 21, 2016, the plaintiff's motion for rehearing *en banc* was granted, and the panel's decision was vacated. On March 23, 2016, the Eleventh Circuit requested briefing on the issues of whether plaintiff's claims are preempted and, if not, whether the defendants' due process rights are violated. On May 18, 2017, the Eleventh Circuit issued its *en banc* opinion. The court held that giving preclusive effect to the findings of negligence and strict liability by the *Engle* jury in individual actions by *Engle* class members against the tobacco companies is not preempted by federal tobacco laws and does not deprive the tobacco companies of due process. The judgment against RJR Tobacco and the remaining defendant was affirmed. The deadline for the defendants to file a petition for writ of certiorari with the U.S. Supreme Court is September 15, 2017.

On June 4, 2013, in *Starr-Blundell v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Duval County, Fla., filed 2007), a jury found for the plaintiff on the negligence and strict liability claims and for the defendants on the intentional tort claims; awarded $500,000 in compensatory damages; found the decedent 80% at fault, RJR Tobacco 10% at fault and the remaining defendant 10% at fault; and did not reach the issue of entitlement to punitive damages. In November 2013, the trial court entered final judgment in the amount of $50,000 against each defendant. On May 29, 2015, the First DCA affirmed the final judgment of the trial court, *per curiam*. On June 29, 2015, the plaintiff filed a notice to invoke the discretionary jurisdiction of the Florida Supreme Court. On May 24, 2016, the Florida Supreme Court accepted jurisdiction of the case, quashed the decision of the First DCA, and remanded the case for reconsideration in light of *Soffer*. On September 6, 2016, the First DCA, *per curiam*, reversed and remanded its May 29, 2015 opinion to the trial court for reconsideration in light of the decision in *Soffer*. Retrial is scheduled for February 2018.

On May 15, 2014, in *Burkhart v. R. J. Reynolds Tobacco Co.* (U.S.D.C. M.D. Fla., filed 2008), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $5 million in compensatory damages; found the plaintiff 50% at fault, RJR Tobacco 25% at fault, Lorillard Tobacco 10% at fault and the remaining defendant 15% at fault; and found that the plaintiff was entitled to punitive damages. On May 16, 2014, the jury awarded punitive damages of $1.25 million against RJR Tobacco, $500,000 against Lorillard Tobacco, and $750,000 against the remaining defendant. In June 2014, the trial court entered final judgment without a reduction for comparative fault. The defendants appealed to the Eleventh Circuit, RJR Tobacco posted a supersedeas bond in the amount of approximately $3.8 million, and Lorillard Tobacco posted a supersedeas bond in the amount of approximately $1.5 million. Oral argument occurred on September 29, 2015. A decision is pending.

On June 23, 2014, in *Bakst v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Palm Beach County, Fla., filed 2007), a case now known as *Odom v. R. J. Reynolds Tobacco Co.*, a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded approximately $6 million in compensatory damages; found the decedent 25% at fault and RJR Tobacco 75% at fault; and found that the plaintiff was entitled to punitive damages. On June 23, 2014, the jury awarded $14 million in punitive damages. The trial court later entered final judgment against RJR Tobacco in the amount of $4.5 million in compensatory damages and $14 million in punitive damages. RJR Tobacco appealed to the Fourth DCA. On November 30, 2016, the Fourth DCA reversed the trial court's judgment and remanded the case with directions that the trial court grant the motion for remittitur or order a new trial on damages only. RJR Tobacco filed a motion for rehearing on January 9, 2017, requesting that the Fourth DCA grant rehearing or withdraw the section of its opinion addressing the propriety of the plaintiff's closing argument or grant rehearing *en banc* on the improper argument issue. On February 27, 2017, the Fourth DCA denied RJR Tobacco's motion for rehearing. The plaintiff filed a notice to invoke the discretionary jurisdiction of the Florida Supreme Court on March 27, 2017. A decision is pending.

On July 17, 2014, in *Robinson v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Escambia County, Fla., filed 2008), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $16.9 million in compensatory damages; found the decedent 29.5% at fault and RJR Tobacco 70.5% at fault; and found that the plaintiff was entitled to punitive damages. On July 18, 2014, the jury awarded $23.6 billion in punitive damages. In July 2014, the trial court entered partial judgment on compensatory damages against RJR Tobacco in the amount of $16.9 million. On January 27, 2015, the trial court remitted the punitive damages award to approximately $16.9 million. In February 2015, RJR Tobacco filed an objection to the remitted award of punitive damages and a demand for a new trial on damages. The trial court granted a new trial on the amount of punitive damages only. The new trial on punitive damages has been stayed pending RJR Tobacco's appeal to the First DCA of the partial judgment of compensatory damages and of the order granting a new trial on the amount of

punitive damages only. On February 24, 2017, the First DCA reversed the judgment of the trial court and remanded the case for a new trial. The new trial has not been scheduled. On May 17, 2017, the First DCA denied the plaintiff's motion for rehearing. The plaintiff filed a notice to invoke the discretionary jurisdiction of the Florida Supreme Court on June 14, 2017. A decision is pending.

On July 31, 2014, in *Harris v. R. J. Reynolds Tobacco Co.* (U.S.D.C. M.D. Fla., filed 2008), a jury found for the plaintiff on the negligence and strict liability claims and for the defendants on the intentional tort claims; awarded $400,000 in compensatory damages for the wrongful death claim and $1.3 million in compensatory damages for the survival claim; allocated fault to the decedent (60% survival/70% wrongful death), RJR Tobacco (15% survival/10% wrongful death), Lorillard Tobacco (10% survival/10% wrongful death), and the remaining defendant (15% survival/10% wrongful death), and found that the plaintiff was not entitled to punitive damages. In December 2014, the trial court entered final judgment. Post-trial motions are pending, but in April 2015, the court stayed all post-trial proceedings pending resolution of the petition for *en banc* consideration in *Graham*, described above. On May 31, 2017, the plaintiff asked the court to lift the stay. A decision is pending.

On August 28, 2014, in *Irimi v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Broward County, Fla., filed 2007), a jury found for the plaintiff on the negligence, strict liability, and certain intentional tort claims and for one or more defendants on certain intentional tort claims; awarded approximately $3.1 million in compensatory damages; found the decedent 70% at fault, RJR Tobacco 14.5% at fault, Lorillard Tobacco 14.5% at fault and the remaining defendant 1% at fault; and did not reach the issue of entitlement to punitive damages. The trial court entered final judgment against each of RJR Tobacco and Lorillard Tobacco in the amount of approximately $453,000 and against the remaining defendant in the amount of approximately $31,000. On January 29, 2015, the court granted the defendants' motion for a new trial. The plaintiff appealed to the Fourth DCA, and the defendants cross appealed. Oral argument occurred on July 12, 2017. A decision is pending.

On October 10, 2014, in *Lourie v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Hillsborough County, Fla., filed 2007), a jury found for the plaintiff on the negligence and strict liability claims and for the defendants on the intentional tort claims; awarded approximately $1.37 million in compensatory damages; found the decedent 63% at fault, RJR Tobacco 3% at fault, Lorillard Tobacco 7% at fault and the remaining defendant 27% at fault; and found that the plaintiff was not entitled to punitive damages. The trial court later entered final judgment. The defendants appealed to the Second DCA in November 2014. On August 10, 2016, the Second DCA affirmed the final judgment. The defendants filed a notice to invoke the discretionary jurisdiction of the Florida Supreme Court on September 8, 2016. On June 19, 2017, the Florida Supreme Court denied the defendants' petition for review based on their decision in *Marotta*, described above. The deadline for the defendants to file a petition for writ of certiorari with the U.S. Supreme Court is September 18, 2017.

On October 20, 2014, in *Kerrivan v. R. J. Reynolds Tobacco Co.* (U.S.D.C. M.D. Fla., filed 2008), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $15.8 million in compensatory damages; found the plaintiff 19% at fault, RJR Tobacco 31% at fault and the remaining defendant 50% at fault; and found that the plaintiff was entitled to punitive damages. On October 22, 2014, the jury awarded $9.6 million in punitive damages against RJR Tobacco and $15.7 million against the remaining defendant. In November 2014, the trial court entered final judgment. RJR Tobacco filed its post-trial motions on December 11, 2014. On June 23, 2017, the court lifted the stay that had been in place pending the *en banc* decision in *Graham*, described above, and directed the parties to file supplemental briefs. Briefs have been submitted, and a decision is pending.

On November 18, 2014, in *Schleider v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Miami-Dade County, Fla., filed 2008), a jury found for the plaintiff on the negligence, strict liability, and certain intentional tort claims and for RJR Tobacco on certain intentional tort claims, awarded $21 million in compensatory damages, found the decedent 30% at fault and RJR Tobacco 70% at fault, and found that the plaintiff was not entitled to punitive damages. In June 2015, the trial court entered final judgment against RJR Tobacco in the amount of $14.7 million. RJR Tobacco appealed to the Third DCA and posted a supersedeas bond in the amount of $5 million. Briefing is complete. Oral argument occurred on June 19, 2017. A decision is pending.

On November 21, 2014, in *Perrotto v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Palm Beach County, Fla., filed 2007), a jury found for the plaintiff on the negligence and strict liability claims and for the defendants on the intentional tort claims; awarded $4.1 million in compensatory damages; found the decedent 49% at fault, RJR Tobacco 20% at fault, Lorillard Tobacco 6% at fault and the remaining defendant 25% at fault; and did not reach the issue of entitlement to punitive damages. Final judgment was entered against RJR Tobacco in the amount of approximately $818,000 and against Lorillard Tobacco in the amount of approximately $245,000. In May 2016, the court granted the plaintiff's motion for a new trial on punitive damages but denied it in all other respects. The new trial is scheduled to begin December 1, 2017.

On December 19, 2014, in *Haliburton v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Palm Beach County, Fla., filed 2008), a jury found that the plaintiff's claims were time-barred, which resulted in a verdict for RJR Tobacco. On April 14, 2015, the trial court entered final judgment in favor of RJR Tobacco. The plaintiff appealed to the Fourth DCA, and RJR Tobacco cross appealed. On February 22, 2017, the Fourth DCA affirmed the judgment of the trial court, *per curiam*. On May 5, 2017, the Fourth DCA denied the plaintiff's motion for written opinion or for certification of a question of great public importance and/or certification of direct conflict to the Florida Supreme Court. The deadline for the plaintiff to file a petition for writ of certiorari with the U.S. Supreme Court is August 3, 2017.

On January 29, 2015, in *Ellen Gray v. R. J. Reynolds Tobacco Co.* (U.S.D.C. M.D. Fla., filed 2008), a jury found for the plaintiff on the negligence and strict liability claims and for RJR Tobacco on the intentional tort claims, awarded $6 million in compensatory damages, and found the decedent 50% at fault and RJR Tobacco 50% at fault. Although the jury ignored an instruction on the verdict form and found that the plaintiff was entitled to punitive damages, there was no punitive damage award. In February 2015, the trial court entered final judgment against RJR Tobacco in the amount of $3 million. Post-trial motions are pending. On June 10, 2015, the court granted RJR Tobacco's motion to stay the case pending resolution of the petition for *en banc* consideration in *Graham*, described above. On June 14, 2017, the court lifted the stay and directed the parties to file supplemental briefs. Briefing is complete. A decision is pending.

On February 10, 2015, in *Hecht v. R. J. Reynolds Tobacco Co*. (U.S.D.C. M.D. Fla., filed 2008), a jury found that the plaintiff's claims were time-barred, which resulted in a verdict in favor of RJR Tobacco. Post-trial proceedings have been stayed until resolution of the petition for *en banc* consideration in *Graham*, described above. However, the trial court entered final judgment in favor of RJR Tobacco on January 7, 2016. On February 2, 2016, the plaintiff appealed to the Eleventh Circuit. Oral argument occurred on January 26, 2017. A decision is pending.

On February 11, 2015, in *Sowers v. R. J. Reynolds Tobacco Co.* (U.S.D.C. M.D. Fla., filed 2008), a jury found for the plaintiff on the negligence and strict liability claims and for RJR Tobacco on the intentional tort claims, awarded $4.25 million in compensatory damages, found the decedent 50% at fault and RJR Tobacco 50% at fault, and did not reach the issue of entitlement to punitive damages. On February 12, 2015, the trial court entered final judgment against RJR Tobacco in the amount of approximately $2.13 million. Post-trial motions are pending. On April 17, 2015, the court stayed post-trial proceedings until resolution of the petition for *en banc* consideration in *Graham*, described above. On June 28, 2017, the court lifted the stay and directed the parties to complete post-trial briefing by August 28, 2017.

On February 24, 2015, in *Caprio v. R. J. Reynolds Tobacco Co*. (Cir. Ct. Broward County, Fla., filed 2007), a jury advised the trial court that it could not reach a unanimous verdict, but the trial court directed the jury to complete the verdict form on those individual verdict questions where there was unanimous agreement. In the partially completed verdict, the jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; found the plaintiff 40% at fault, RJR Tobacco 20% at fault, Lorillard Tobacco 10% at fault, and the remaining defendants 30% at fault; and awarded $559,000 in economic damages. The jury did not answer the verdict form questions relating to noneconomic damages and entitlement to punitive damages. In May 2015, the court denied the defendants' motion for a mistrial and advised that it accepted the questions answered by the jurors as a partial verdict. A new trial will be held on the remaining issues, including comparative fault allocation. The defendants appealed to the Fourth DCA. On January 22, 2017, the defendants dismissed their appeal. The case remains pending in the trial court. The new trial is scheduled for August 9, 2017.

On February 26, 2015, in *Zamboni v. R. J. Reynolds Tobacco Co.* (U.S.D.C. M.D. Fla., filed 2008), a jury found for the plaintiff on the negligence and strict liability claims and for the defendants on the intentional tort claims; awarded the plaintiff $340,000 in compensatory damages; found the decedent 60% at fault, RJR Tobacco 30% at fault and the remaining defendant 10% at fault; and did not reach the issue of entitlement to punitive damages. Post-trial motions are pending. The court stayed the case pending resolution of the petition for *en banc* consideration in *Graham*, described above. On June 2, 2017, the plaintiff asked the court to lift the stay. A decision is pending.

On March 23, 2015, in *Pollari v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Broward County, Fla., filed 2007), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $10 million in compensatory damages; found the decedent 15% at fault, RJR Tobacco 42.5% at fault and the remaining defendant 42.5% at fault; and found that the plaintiff was entitled to punitive damages. On March 25, 2015, the jury awarded $1.5 million in punitive damages against each defendant. The trial court later entered final judgment against the defendants in the amount of $10 million in compensatory damages and, against each

defendant, $1.5 million in punitive damages. On January 12, 2016, the trial court entered a second amended final judgment against RJR Tobacco that awarded $4.25 million in compensatory damages and $1.5 million in punitive damages. The defendants appealed to the Fourth DCA, RJR Tobacco posted a supersedeas bond in the amount of $2.5 million, and the plaintiff cross appealed. Oral argument occurred on June 27, 2017. A decision is pending.

On March 26, 2015, in *Gore v. R. J. Reynolds Tobacco Co*. (Cir. Ct. Indian River County, Fla., filed 2008), a jury, in a retrial following a mistrial, found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $2 million in compensatory damages; found the decedent 54% at fault, RJR Tobacco 23% at fault and the remaining defendant 23% at fault; and found that the plaintiff was not entitled to punitive damages. In September 2015, the trial court entered final judgment against RJR Tobacco and the remaining defendant, each in the amount of $460,000. RJR Tobacco posted a supersedeas bond in the amount of $460,000 in September 2015, and in October 2015, the defendants appealed to the Fourth DCA, and the plaintiff cross appealed. Briefing is complete. Oral argument has not been scheduled.

On April 17, 2015, in *Ryan v. R. J. Reynolds Tobacco Co*. (Cir. Ct. Broward County, Fla., filed 2007), a jury, in a retrial following a mistrial, found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $21.5 million in compensatory damages; found the plaintiff 35% at fault and RJR Tobacco 65% at fault; and found that the plaintiff was entitled to punitive damages. On April 21, 2015, the jury awarded $25 million in punitive damages. In May 2015, the trial court entered final judgment against RJR Tobacco in the amount of $21.5 million in compensatory damages and $25 million in punitive damages. On April 29, 2016, the court entered an amended final judgment against RJR Tobacco in the amount of approximately $14 million in compensatory damages and $25 million in punitive damages. RJR Tobacco filed a notice of appeal to the Fourth DCA and posted a supersedeas bond in the amount of $5 million on May 27, 2016. The plaintiff filed a notice of cross appeal on June 13, 2016. Briefing is complete. Oral argument has not been scheduled.

On June 18, 2015, in *Hardin v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Miami-Dade County, Fla., filed 2007), a jury found for the plaintiff on the negligence and strict liability claims and for RJR Tobacco on the intentional tort claims, awarded $776,000 in compensatory damages, found the decedent 87% at fault and RJR Tobacco 13% at fault, and found that the plaintiff was not entitled to punitive damages. In June 2015, the trial court entered final judgment against RJR Tobacco in the amount of $100,880. The plaintiff appealed to the Third DCA, and RJR Tobacco cross appealed. On December 21, 2016, the Third DCA remanded the case for a new trial limited to the issue of punitive damages for the plaintiff's non-intentional tort claims. Otherwise, the final judgment was affirmed. Neither party sought further review. The new trial is scheduled to begin August 21, 2017.

On July 13, 2015, in *McCoy v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Broward County, Fla., filed 2007), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $1.5 million in compensatory damages; found the decedent 35% at fault, RJR Tobacco 25% at fault, Lorillard Tobacco 20% at fault and the remaining defendant 20% at fault; and found that the plaintiff was entitled to punitive damages. On July 17, 2015, the jury awarded $3 million in punitive damages against each defendant. In August 2015, the trial court entered final judgment against RJR Tobacco, RJR Tobacco as successor-by-merger to Lorillard Tobacco, and the remaining defendant, jointly and severally, in the amount of $1.5 million in compensatory damages and, against each of them, $3 million in punitive damages. On January 4, 2016, the trial court entered an amended final judgment in the amount of $370,000 in compensatory damages and $3 million in punitive damages against RJR Tobacco, $300,000 in compensatory damages and $3 million in punitive damages against RJR Tobacco as successor-by-merger to Lorillard Tobacco, and $300,000 in compensatory damages and $3 million in punitive damages against the remaining defendant. RJR Tobacco appealed to the Fourth DCA and posted a supersedeas bond in the amount of approximately $3.35 million, and the plaintiff filed a notice of cross appeal. Oral argument is scheduled for September 26, 2017.

On July 29, 2015, in *Collar v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Indian River County, Fla., filed 2008), a jury found that the plaintiff was not a class member, which resulted in a verdict for the defendants, including RJR Tobacco. In September 2015, the trial court entered final judgment. The plaintiff appealed to the Fourth DCA, and the defendants cross appealed. Oral argument occurred on June 13, 2017. On July 5, 2017, the Fourth DCA reversed the judgment of the trial court and remanded the case for a new trial. The deadline for the defendants to file a notice to invoke the discretionary jurisdiction of the Florida Supreme Court is August 4, 2017.

On August 6, 2015, in *Block v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Broward County, Fla., filed 2007), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded approximately $1.03 million in compensatory damages; found the decedent 50% at fault and RJR Tobacco 50% at fault; and found that the plaintiff was entitled to punitive damages. On August 7, 2015, the jury awarded $800,000 in

punitive damages. In September 2015, the trial court entered final judgment against RJR Tobacco in the amount of approximately $926,000 in compensatory damages and $800,000 in punitive damages. On December 9, 2015, the trial court granted RJR Tobacco's motion to alter or amend the judgment in part in light of the Fourth DCA's decision in *Schoeff v. R. J. Reynolds Tobacco Co.*, described above, finding that the intentional tort exception in Section 768.81, Florida Statutes, does not apply to the fraud and conspiracy claims brought by *Engle* Progeny plaintiffs. As a result, an amended final judgment was entered in the amount of approximately $463,000 in compensatory damages and $800,000 in punitive damages. RJR Tobacco appealed to the Fourth DCA and posted a supersedeas bond in the amount of approximately $1.3 million, and the plaintiff filed a notice of cross appeal. On February 3, 2017, the Fourth DCA entered an order dispensing with oral argument. On April 27, 2017, the Fourth DCA affirmed the judgment of the trial court, *per curiam.* The deadline for RJR Tobacco to file a petition for writ of certiorari with the U.S. Supreme Court is September 22, 2017.

On September 1, 2015, in *Lewis v. R. J. Reynolds Tobacco Co*. (Cir. Ct. Volusia County, Fla., filed 2007), a jury found for the plaintiff on the negligence and strict liability claims and for RJR Tobacco on the intentional tort claims, awarded $750,000 in compensatory damages, found the decedent 75% at fault and RJR Tobacco 25% at fault, and found that the plaintiff was not entitled to punitive damages. Final judgment was entered against RJR Tobacco in the amount of $187,500 in March 2016. RJR Tobacco appealed to the Fifth DCA and posted a supersedeas bond in the amount of $187,500. On May 2, 2017, the Fifth DCA affirmed the final judgment of the trial court, *per curiam*. The deadline for RJR Tobacco to file a petition for writ of certiorari with the U.S. Supreme Court is September 29, 2017.

On September 8, 2015, in *Cooper v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Broward County, Fla., filed 2007), a jury found for the plaintiff on the negligence and strict liability claims and for the defendants on the intentional tort claims; awarded $4.5 million in compensatory damages; found the plaintiff 50% at fault, RJR Tobacco 40% at fault and the remaining defendant 10% at fault; and did not reach the issue of entitlement to punitive damages. Post-trial motions were denied on December 2, 2015. In February 2016, the trial court entered final judgment against RJR Tobacco in the amount of approximately $1.2 million. The defendants appealed to the Fourth DCA, and the plaintiff cross appealed. RJR Tobacco posted a supersedeas bond in the amount of approximately $1.2 million. Briefing is complete. Oral argument has not been scheduled.

On September 10, 2015, in *Duignan v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Pinellas County, Fla., filed 2007), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $6 million in compensatory damages; found the decedent 33% at fault, RJR Tobacco 30% at fault, and the remaining defendant 37% at fault; and found that the plaintiff was entitled to punitive damages. On September 11, 2015, the jury awarded $2.5 million in punitive damages against RJR Tobacco and $3.5 million in punitive damages against the remaining defendant. The trial court later entered final judgment against RJR Tobacco and the remaining defendant in the amount of $6 million in compensatory damages and $2.5 million in punitive damages against RJR Tobacco and $3.5 million in punitive damages against the remaining defendant. The defendants appealed to the Second DCA, and RJR Tobacco posted a supersedeas bond in the amount of approximately $2.3 million. Oral argument occurred on December 5, 2016. A decision is pending.

On September 10, 2015, in *O'Hara v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Escambia County, Fla., filed 2007), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $14.7 million in compensatory damages; found the decedent 15% at fault and RJR Tobacco 85% at fault; and found that the plaintiff was entitled to punitive damages. On September 11, 2015, the jury awarded $20 million in punitive damages. In September 2015, the trial court entered final judgment against RJR Tobacco in the amount of $14.7 million in compensatory damages and $20 million in punitive damages. RJR Tobacco appealed to the First DCA and posted a supersedeas bond in the amount of $5 million. Oral argument occurred on May 10, 2017. A decision is pending.

On September 22, 2015, in *Suarez v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Miami-Dade County, Fla., filed 2008), a jury found that the decedent was not a class member, which resulted in a verdict for the defendants, including RJR Tobacco. In November 2015, the trial court entered final judgment. The plaintiff appealed to the Third DCA, and the defendants cross appealed. On October 19, 2016, the Third DCA affirmed the judgment of the trial court, *per curiam*. On October 27, 2016, the plaintiff filed a motion for a written opinion and certification to the Florida Supreme Court, which was denied on May 19, 2017. The deadline for the plaintiff to file a petition for writ of certiorari with the U.S. Supreme Court is August 17, 2017.

On October 2, 2015, in *Marchese v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Broward County, Fla., filed 2007), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $1 million in compensatory damages; found the decedent 55% at fault, RJR Tobacco 22.5% at fault, and the remaining

defendant 22.5% at fault; and found that the plaintiff was entitled to punitive damages. On October 6, 2015, the jury awarded $250,000 in punitive damages against each defendant. Final judgment was entered on November 5, 2015. On May 17, 2016, an amended final judgment was entered in the amount of $450,000 in compensatory damages against RJR Tobacco and the remaining defendant, jointly and severally, and $250,000 in punitive damages against each defendant. RJR Tobacco appealed to the Fourth DCA and posted a supersedeas bond in the amount of $475,000. Briefing is complete. Oral argument has not been scheduled.

On November 17, 2015, in *Barbose v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Pasco County, Fla., filed 2007), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $10 million in compensatory damages, found the decedent 15% at fault, RJR Tobacco 42.5% at fault and the remaining defendant 42.5% at fault; and found that the plaintiff was entitled to punitive damages. On November 18, 2015, the jury awarded $500,000 in punitive damages against each of RJR Tobacco and the other defendant. The defendants appealed to the Second DCA, and RJR Tobacco posted a supersedeas bond in the amount of $2.5 million. Oral argument is scheduled for August 8, 2017.

On November 20, 2015, in *Fanali v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Palm Beach County, Fla., filed 2008), a jury found that cigarette smoking was not a legal cause of the decedent's coronary artery disease and death, which resulted in a verdict for RJR Tobacco. On December 17, 2015, the trial court entered final judgment in favor of RJR Tobacco. The plaintiff appealed to the Fourth DCA, and RJR Tobacco cross appealed. On June 21, 2017, the Fourth DCA affirmed the final judgment of the trial court. On July 13, 2017, the plaintiff filed a motion for rehearing and filed an amended motion for rehearing on July 14, 2017. A decision is pending.

On November 24, 2015, in *Green v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Miami-Dade County, Fla., filed 2007), a jury found that the plaintiff does not have chronic obstructive pulmonary disease, which resulted in a verdict for RJR Tobacco. Post-trial motions were denied on March 23, 2016. On April 4, 2016, final judgment was entered in favor of RJR Tobacco. The plaintiff appealed to the Third DCA, and RJR Tobacco cross appealed. On May 3, 2017, the Third DCA affirmed the final judgment of the trial court, *per curiam*. The plaintiff did not seek further review.

On December 9, 2015, in *Monroe v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Gadsden County, Fla., filed 2007), a jury found for the plaintiff on the negligence and strict liability claims and for RJR Tobacco on the intentional tort claims, awarded $11 million in compensatory damages, found the plaintiff 42% at fault and RJR Tobacco 58% at fault, and did not reach the issue of entitlement to punitive damages. On December 31, 2015, the trial court entered final judgment against RJR Tobacco in the amount of $6.38 million in compensatory damages. RJR Tobacco appealed to the First DCA and posted a supersedeas bond in the amount of $5 million. On March 23, 2017, the First DCA affirmed the judgment of the trial court, *per curiam*. On April 19, 2017, RJR Tobacco filed a notice to invoke the discretionary jurisdiction of the Florida Supreme Court. On June 13, 2017, the Florida Supreme Court declined to accept jurisdiction. The deadline for RJR Tobacco to file a petition for writ of certiorari with the U.S. Supreme Court is September 11, 2017.

On December 18, 2015, in *Ledoux v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Miami-Dade County, Fla., filed 2007), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $10 million in compensatory damages; found the decedent 6% at fault, RJR Tobacco 47% at fault and the remaining defendant 47% at fault; and found that the plaintiff was entitled to punitive damages. On December 22, 2015, the jury awarded $12.5 million in punitive damages against each defendant. The trial court later entered final judgment against the defendants, jointly and severally, in the amount of $10 million in compensatory damages and, against each defendant, $12.5 million in punitive damages. The defendants appealed to the Third DCA, and RJR Tobacco posted a supersedeas bond in the amount of $5 million. On May 27, 2016, RJR Tobacco filed a rider amending the supersedeas bond reducing the amount from $5 million to $2.5 million. Oral argument occurred on April 11, 2017. A decision is pending.

On January 26, 2016, in *Ewing v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Escambia County, Fla., filed 2008), a jury found for the plaintiff on the negligence and strict liability claims and for the defendants on the intentional tort claims; awarded $240,000 in compensatory damages; found the decedent 98% at fault, RJR Tobacco 2% at fault and the remaining defendant 0% at fault, and did not reach the issue of entitlement to punitive damages. Post-trial motions were denied on February 25, 2016. Final judgment has not been entered.

On February 12, 2016, in *Ahrens v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Pinellas County, Fla., filed 2008), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $9 million in compensatory damages; found the decedent 32% at fault, RJR Tobacco 44% at fault, and the remaining defendant 24% at fault; and found that the plaintiff was entitled to punitive damages. On February 13, 2016, the

jury awarded $2.5 million in punitive damages against each defendant. In February 2016, the trial court entered final judgment. On April 13, 2016, RJR Tobacco appealed to the Second DCA and posted a supersedeas bond in the amount of $2.5 million. On May 12, 2017, the Second DCA affirmed the final judgment of the trial court, *per curiam*. On May 24, 2017, the defendants filed a motion for a written opinion or citation. On July 14, 2017, the Second DCA granted the defendants' motion for a written opinion, withdrew the May 12, 2017 decision and substituted the July 14, 2017 opinion, which affirmed the final judgment in all respects without further discussion while certifying a conflict to the Florida Supreme Court on the application of comparative fault. The deadline for the defendants to file a notice to invoke the discretionary jurisdiction of the Florida Supreme Court is August 11, 2017.

On March 8, 2016, in *Gamble v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Duval County, Fla., filed 2008), a jury found for the plaintiff on class membership, but found for RJR Tobacco on addiction causation, which resulted in a verdict for RJR Tobacco. Final judgment was entered in favor of RJR Tobacco on June 9, 2016. The plaintiff appealed to the First DCA on July 8, 2016. Briefing is complete. Oral argument has not been scheduled.

On April 7, 2016, in *Davis v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Miami-Dade County, Fla., filed 2008), a jury found for the plaintiff on class membership, but found for RJR Tobacco on addiction causation, which resulted in a verdict for RJR Tobacco. On August 17, 2016, the court granted the plaintiff's motion for a new trial. RJR Tobacco filed a notice of appeal to the Third DCA on August 25, 2016. Oral argument is scheduled for August 16, 2017.

On April 21, 2016, in *Turner v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Broward County, Fla., filed 2007), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $3 million in compensatory damages; found the decedent 20% at fault and RJR Tobacco 80% at fault; and found that the plaintiff was entitled to punitive damages. On April 22, 2016, the jury awarded $10 million in punitive damages. The court entered judgment against RJR Tobacco in the amount of $2.4 million in compensatory damages and $10 million in punitive damages. In July 2016, RJR Tobacco filed a notice of appeal to the Fourth DCA and posted a supersedeas bond in the amount of $5 million. The plaintiff filed a notice of cross appeal in August 2016. Oral argument occurred on July 25, 2017. A decision is pending.

On April 26, 2016, in *Enochs v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Palm Beach County, Fla., filed 2007), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $21 million in compensatory damages; found the decedent 22% at fault, RJR Tobacco 66% at fault and the remaining defendant 12% at fault; and found that the plaintiff was entitled to punitive damages. On April 27, 2016, the jury awarded $6.25 million in punitive damages against each defendant. Final judgment was entered against RJR Tobacco in the amount of approximately $13.9 million in compensatory damages and $6.25 million in punitive damages on May 9, 2016. The defendants appealed to the Fourth DCA, and RJR Tobacco posted a supersedeas bond in the amount of approximately $3.5 million. Oral argument occurred on July 18, 2017. A decision is pending.

On May 11, 2016, in *Dion v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Sarasota County, Fla., filed 2007), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $12 million in compensatory damages; found the decedent 25% at fault and RJR Tobacco 75% at fault; and found that the plaintiff was entitled to punitive damages. On May 12, 2016, the jury awarded $30,000 in punitive damages. On August 9, 2016, RJR Tobacco filed a notice of appeal to the Second DCA and posted a supersedeas bond in the amount of $5 million. Oral argument is scheduled for September 28, 2017.

On May 16, 2016, in *Nally v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Polk County, Fla., filed 2007), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $6 million in compensatory damages; found the decedent 25% at fault and RJR Tobacco 75% at fault; and found that the plaintiff was entitled to punitive damages. On May 17, 2016, the jury awarded $12 million in punitive damages. Final judgment was entered against RJR Tobacco in the amount of $6 million in compensatory damages and $12 million in punitive damages on May 25, 2016. In September 2016, RJR Tobacco filed a notice of appeal to the Second DCA and posted a supersedeas bond in the amount of $5 million. Briefing is underway.

On May 19, 2016, in *McCabe v. R. J. Reynolds Tobacco Co*. (Cir. Ct. Hillsborough County, Fla., filed 2007), a jury found for the plaintiff on the negligence and strict liability claims, awarded $5 million in compensatory damages, found the decedent 70% at fault and RJR Tobacco 30% at fault, and found that the plaintiff was entitled to punitive damages. On May 20, 2016, the jury awarded $6.5 million in punitive damages. Final judgment was entered against RJR Tobacco in the amount of $1.5 million in compensatory damages and $6.5 million in punitive damages on May 31, 2016. Post-trial motions were denied on January 26, 2017. On February 24, 2017, RJR Tobacco filed a notice of appeal to the Second DCA. RJR Tobacco posted a supersedeas bond in the amount of $5 million on February 27, 2017. Briefing is underway.

On June 21, 2016, in *Mooney v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Miami-Dade County, Fla., filed 2008), a jury found that the decedent's addiction to nicotine was not a legal cause of her death, which resulted in a verdict for the defendants, including RJR Tobacco. Final judgment has not been entered.

On July 1, 2016, in *Sermons v. Philip Morris USA Inc.* (Cir. Ct. Duval County, Fla., filed 2008), a jury found for the plaintiff on the negligence and strict liability claims; awarded $65,000 in compensatory damages; found the decedent 80% at fault, RJR Tobacco 5% at fault, and the remaining defendant 15% at fault; and found that the plaintiff was entitled to punitive damages. On July 6, 2016, the jury awarded $17,075 in punitive damages against RJR Tobacco and $51,225 in punitive damages against the remaining defendant. Post-trial motions are pending.

On August 15, 2016, in *Mathis v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Miami-Dade County, Fla., filed 2007), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $5 million in compensatory damages; found the decedent 45% at fault and RJR Tobacco 55% at fault; and found that the plaintiff was not entitled to punitive damages. Final judgment was entered on August 17, 2016. RJR Tobacco filed a notice of appeal to the Third DCA and posted a supersedeas bond in the amount of $5 million on November 18, 2016. Briefing is underway.

On August 25, 2016, in *Coursey v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Volusia County, Fla., filed 2007), a jury found that the decedent was not a class member, which resulted in a verdict for RJR Tobacco. Final judgment was entered in RJR Tobacco's favor on September 27, 2016. On October 27, 2016, the plaintiff filed a notice of appeal to the Fifth DCA. RJR Tobacco filed a notice of cross appeal on November 8, 2016. Briefing is underway.

On September 6, 2016, in *Hackimer v. R. J. Reynolds Tobacco Co*. (Cir. Ct. Palm Beach County, Fla., filed 2007), a jury found that the deceased smoker knew or should have known of his chronic obstructive pulmonary disease before May 5, 1990, and, for that reason, the claims were barred by the statute of limitations, which resulted in a verdict for RJR Tobacco. On January 4, 2017, final judgment was entered in favor of RJR Tobacco. The plaintiff filed a notice of appeal to the Fourth DCA on February 1, 2017. RJR Tobacco filed a notice of cross appeal on February 9, 2017. Briefing is underway.

On September 22, 2016, in *Oshinsky-Blacker v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Broward County, Fla., filed 2007), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $6.15 million in compensatory damages; found the decedent 15% at fault, RJR Tobacco 25% at fault, and the remaining defendant 60% at fault; and found that the plaintiff was entitled to punitive damages. On September 23, 2016, the jury awarded $2 million in punitive damages against RJR Tobacco and $1 million in punitive damages against the remaining defendant. On March 6, 2017, the court granted the defendants' motion for a new trial. The new trial has not been scheduled. The plaintiff filed a notice of appeal to the Fourth DCA on March 24, 2017. The defendants filed a notice of cross appeal on March 31, 2017. Briefing is underway.

On September 23, 2016, in *Sherry Smith v. R. J. Reynolds Tobacco Co*. (Cir. Ct. Volusia County, Fla., filed 2008), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $3 million in compensatory damages; found the decedent 35% at fault and RJR Tobacco 65% at fault; and found that the plaintiff was not entitled to punitive damages. Final judgment was entered against RJR Tobacco in the amount of $3 million. In January 2017, RJR Tobacco filed a notice of appeal to the Fifth DCA and posted a supersedeas bond in the amount of $3 million. Briefing is underway.

On September 28, 2016, in *Prentice v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Duval County, Fla., filed 2007), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $6.4 million in compensatory damages; found the decedent 60% at fault and RJR Tobacco 40% at fault; and found that the plaintiff was entitled to punitive damages. On September 29, 2016, the jury awarded $0 in punitive damages. Post-trial motions were denied on April 11, 2017, and final judgment was entered against RJR Tobacco in the amount of $6.4 million. RJR Tobacco filed a notice of appeal to the First DCA on May 11, 2017, and the plaintiff filed a notice of cross appeal on May 19, 2017. Briefing is underway.

On October 24, 2016, in *Konzelman v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Broward County, Fla., filed 2007), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded approximately $8.8 million in compensatory damages; found the decedent 15% at fault and RJR Tobacco 85% at fault; and found that the plaintiff was entitled to punitive damages. On October 26, 2016, the jury awarded $20 million in punitive damages. On December 1, 2016, the trial court entered final judgment against RJR Tobacco in the amount of approximately $7.48 million in compensatory damages and $20 million in punitive damages. RJR Tobacco filed a notice of appeal to the Fourth DCA and posted a supersedeas bond in the amount of $5 million on December 22, 2016. The plaintiff filed a notice of cross appeal on January 2, 2017. Briefing is underway.

On November 2, 2016, in *Johnston v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Sarasota County, Fla., filed 2007), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $7.5 million in compensatory damages; found the decedent 10% at fault and RJR Tobacco 90% at fault; and found that the plaintiff was entitled to punitive damages. On November 5, 2016, the jury awarded $14 million in punitive damages. Final judgment was entered against RJR Tobacco in the amount of $6.75 million in compensatory damages and $14 million in punitive damages on November 28, 2016. Post-trial motions were denied on March 30, 2017. RJR Tobacco filed a notice of appeal to the Second DCA on April 25, 2017, and posted a supersedeas bond in the amount of $5 million on April 26, 2017. The plaintiff filed a notice of cross appeal on May 17, 2017. Briefing is underway.

On November 3, 2016, in *Ledo v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Miami-Dade County, Fla., filed 2008), a jury found for the plaintiff on the negligence and strict liability claims and for RJR Tobacco on the intentional tort claims; awarded $6 million in compensatory damages; found the decedent 51% at fault and RJR Tobacco 49% at fault; and found that the plaintiff was entitled to punitive damages. After receiving the verdict, the trial court granted a directed verdict in favor of RJR Tobacco on entitlement to punitive damages. Final judgment was entered against RJR Tobacco in the amount of $2.94 million in compensatory damages on December 22, 2016. Post-trial motions are pending.

On November 10, 2016, in *Howles v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Broward County, Fla., filed 2007), a jury found for the plaintiff on the negligence, strict liability and intentional tort claims; awarded $4 million in compensatory damages; found RJR Tobacco 50% at fault and the remaining defendant 50% at fault; and found that the plaintiff was entitled to punitive damages. On November 14, 2016, the jury awarded $3 million in punitive damages against RJR Tobacco and $3 million against the remaining defendant. Final judgment was entered against RJR Tobacco in the amount of $2 million in compensatory damages and $3 million in punitive damages. On December 30, 2016, the defendants filed a joint notice of appeal to the Fourth DCA. Briefing is underway.

On November 16, 2016, in *Ford v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Palm Beach County, Fla., filed 2008), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded approximately $1.02 million in compensatory damages; found the plaintiff 85% at fault and RJR Tobacco 15% at fault; and found that the plaintiff was not entitled to punitive damages. The trial court entered final judgment against RJR Tobacco in the amount of approximately $153,400 on March 13, 2017. Post-trial motions were denied on June 6, 2017. On June 12, 2017, the plaintiff filed a notice of appeal to the Fourth DCA. RJR Tobacco filed a notice of cross appeal on June 21, 2017. Briefing is underway.

On November 16, 2016, in *Stanley Martin v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Broward County, Fla., filed 2007), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded approximately $5.41 million in compensatory damages; found the decedent 32% at fault, RJR Tobacco 22% at fault and the remaining defendant 46% at fault; and found that the plaintiff was entitled to punitive damages. On November 18, 2016, the jury awarded $200,000 in punitive damages against RJR Tobacco and $450,000 against the remaining defendant. Final judgment was entered against RJR Tobacco in the amount of approximately $1.2 million in compensatory damages and $200,000 in punitive damages and against the remaining defendant in the amount of $2.5 million in compensatory damages and $450,000 in punitive damages. Post-trial motions were denied on January 26, 2017. On February 23, 2017, the defendants filed a joint notice of appeal to the Fourth DCA, and RJR Tobacco posted a supersedeas bond in the amount of approximately $1.4 million. The plaintiff filed a notice of cross appeal on February 24, 2017. Briefing is underway.

On December 16, 2016, in *Dubinsky v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Brevard County, Fla., filed 2008), a jury found that the decedent was not a class member, which resulted in a verdict for the defendants, including RJR Tobacco. Final judgment was entered in favor of the defendants on April 3, 2017. The plaintiff did not seek further review.

On December 16, 2016, in *Pardue v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Alachua County, Fla., filed 2008), a jury, in a retrial following a mistrial, found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded approximately $5.9 million in compensatory damages; found the decedent 25% at fault, RJR Tobacco 50% at fault, and the remaining defendant 25% at fault; and found that the plaintiff was entitled to punitive damages. On December 19, 2016, the jury awarded $6.75 million in punitive damages against RJR Tobacco and $6.75 million in punitive damages against the remaining defendant. Final judgment was entered against RJR Tobacco in the amount of approximately $5.9 million in compensatory damages (jointly and severally with the remaining defendant) and, against each defendant, $6.75 million in punitive damages on December 29, 2016. An amended final judgment was entered against RJR Tobacco in the amount of

approximately $5.2 million in compensatory damages (jointly and severally with the remaining defendant) and, against each defendant, $6.75 million in punitive damages. Post-trial motions were denied on April 19, 2017. On March 8, 2017, the defendants filed a notice of appeal to the First DCA, and RJR Tobacco posted a supersedeas bond in the amount of $2.5 million on March 9, 2017. Briefing is underway.

On February 8, 2017, in *Durrance v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Highlands County, Fla., filed 2011), a jury found that the decedent knew or should have known of her chronic obstructive pulmonary disease before May 5, 1990, which resulted in a verdict for RJR Tobacco. Final judgment was entered in favor of RJR Tobacco on April 26, 2017. On May 16, 2017, the plaintiff filed a notice of appeal to the Second DCA. RJR Tobacco filed a notice of cross appeal on May 17, 2017. Briefing is underway.

On February 15, 2017, in *John Brown v. Philip Morris USA Inc.* (Cir. Ct. Pinellas County, Fla., filed 2007), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $5.4 million in compensatory damages; found the decedent 30% at fault, RJR Tobacco 35% at fault and the remaining defendant 35% at fault; and found that the plaintiff was entitled to punitive damages. On February 17, 2017, the jury awarded $200,000 each in punitive damages against RJR Tobacco and the remaining defendant. Post-trial motions are pending.

On February 23, 2017, in *Fox v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Broward County, Fla., filed 2007), a jury found for the plaintiff on the negligence and strict liability claims and for RJR Tobacco on the intentional tort claims; awarded $6 million in compensatory damages; found the decedent 50% at fault and RJR Tobacco 50% at fault; and found that the plaintiff was not entitled to punitive damages. Post-trial motions were denied on May 3, 2017, and final judgment was entered against RJR Tobacco in the amount of $3 million. RJR Tobacco filed a notice of appeal to the Fourth DCA on July 24, 2017. Briefing is underway.

On March 28, 2017, in *Whitmire v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Leon County, Fla., filed 2008), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $3 million in compensatory damages; found the decedent 33% at fault and RJR Tobacco 67% at fault; and found that the plaintiff was entitled to punitive damages. On March 29, 2017, the court declared a mistrial in the punitive damages phase because the jury was deadlocked. On April 6, 2017, final judgment was entered against RJR Tobacco in the amount of $3 million in compensatory damages. Post-trial motions were denied on April 19, 2017. RJR Tobacco filed a notice of appeal to the First DCA on May 15, 2017, and posted a supersedeas bond in the amount of $3 million on June 6, 2017. Briefing is underway.

On March 29, 2017, in *Santoro v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Broward County, Fla., filed 2007), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded approximately $1.6 million in compensatory damages; found the decedent 36% at fault, RJR Tobacco 26% at fault, and the remaining defendants 38% at fault; and found that the plaintiff was entitled to punitive damages. On March 31, 2017, the jury awarded $90,000 in punitive damages against RJR Tobacco and $115,000 against the remaining defendants. On April 5, 2017, an amended final judgment was entered against RJR Tobacco in the amount of $507,300 and against the remaining defendant in the amount of $724,900. Post-trial motions are pending.

On April 18, 2017, in *Schlefstein v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Broward County, Fla., filed 2007), the court declared a mistrial during jury selection. Retrial has been scheduled for January 16, 2018.

On April 20, 2017, in *Lima v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Hillsborough County, Fla., filed 2007), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $3 million in compensatory damages; found the decedent 40% at fault, RJR Tobacco 60% at fault, and the remaining defendant 0% at fault; and found that the plaintiff was entitled to punitive damages with respect to RJR Tobacco and that the plaintiff was not entitled to punitive damages with respect to the other defendant. On April 21, 2017, the jury awarded $12 million in punitive damages against RJR Tobacco.

Final judgment was entered against RJR Tobacco in the amount of $1.8 million in compensatory damages and $12 million in punitive damages on April 25, 2017. Post-trial motions are pending.

On April 24, 2017, in *Shadd v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Palm Beach County, Fla., filed 2007), a jury found for the plaintiff on the negligence and strict liability claims and for RJR Tobacco on the intentional tort claims; awarded $0 in compensatory damages; found that the decedent was 95% at fault and RJR Tobacco 5% at fault; and found that the plaintiff was not entitled to punitive damages. Post-trial motions are pending.

On May 9, 2017, in *Lawrence v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Marion County, Fla., filed 2007), a jury found for the plaintiff on the negligence and strict liability claims and for RJR Tobacco on the intentional tort claims; awarded approximately $858,200 in compensatory damages; found the decedent was 65% at fault

and RJR Tobacco 35% at fault, and found that the plaintiff was entitled to punitive damages. Prior to the punitive damages phase, the parties resolved the matter. Final judgment was entered against RJR Tobacco in the amount of approximately $300,000. RJR Tobacco paid approximately $2.9 million on June 29, 2017 in satisfaction of the judgment (including fees and interest).

On May 11, 2017, in *Sheffield v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Orange County, Fla., filed 2007), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $1.8 million in compensatory damages; found the decedent 40% at fault and RJR Tobacco 60% at fault; and found that the plaintiff was entitled to punitive damages. On May 12, 2017, the jury awarded $5 million in punitive damages against RJR Tobacco. Post-trial motions were denied on July 10, 2017, and final judgment was entered against RJR Tobacco in the amount of $1.8 million in compensatory damages and $5 million in punitive damages. The deadline for RJR Tobacco to file a notice of appeal to the Fifth DCA is August 9, 2017.

On May 23, 2017, in *Olson v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Duval County, Fla., filed 2008), the court granted RJR Tobacco's motions for a mistrial due to an error with the instructions provided to the jury. Retrial is scheduled for August 6, 2018.

On June 2, 2017, in *Kogan v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Palm Beach County, Fla., filed 2007), a jury found that an addiction to cigarettes containing nicotine was not the legal cause of the plaintiff's bladder cancer, which resulted in a verdict for the defendants, including RJR Tobacco. Final judgment was entered on June 22, 2017. On July 18, 2017, the plaintiff filed a notice of appeal to the Fourth DCA. Briefing is underway.

On June 7, 2017, in *Gay v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Hillsborough County, Fla., filed 2007), the court declared a mistrial due to comments made by a prospective juror during jury selection. Retrial is rescheduled tentatively for September 8, 2017.

On July 18, 2017, in *Maloney v. R. J. Reynolds Tobacco Co*. (Cir. Ct. Lee County, Fla., filed 2007), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $1.65 million in compensatory damages; found the decedent 50% at fault and RJR Tobacco 50% at fault; and found that the plaintiff was not entitled to punitive damages. Post-trial motions are pending.

On July 28, 2017, in *Thomas v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Broward County, Fla., filed 2007), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $4 million in compensatory damages; found the decedent 45% at fault and RJR Tobacco 55% at fault; and found that the plaintiff was not entitled to punitive damages. Post-trial motions are pending.

Broin II Cases

Broin v. Philip Morris, Inc. (Cir. Ct. Miami-Dade County, Fla., filed 1991), was a class action brought on behalf of flight attendants alleged to have suffered from diseases or ailments caused by exposure to ETS in airplane cabins. In October 1997, RJR Tobacco, Lorillard Tobacco, B&W and other cigarette manufacturer defendants settled *Broin*, agreeing to pay a total of $300 million in three annual $100 million installments, allocated among the companies by market share, to fund research on the early detection and cure of diseases associated with tobacco smoke. It also required those companies to pay a total of $49 million for the plaintiffs' counsel's fees and expenses. RJR Tobacco's portion of these payments was approximately $86 million; Lorillard Tobacco's was approximately $57 million; and B&W's was approximately $31 million. The settlement agreement, among other things, limits the types of claims class members may bring and eliminates claims for punitive damages. The settlement agreement also provides that, in individual cases by class members that are referred to as *Broin II* lawsuits, the defendant will bear the burden of proof with respect to whether ETS can cause certain specifically enumerated diseases, referred to as "general causation." With respect to all other liability issues, including whether an individual plaintiff's disease was caused by his or her exposure to ETS in airplane cabins, referred to as "specific causation," individual plaintiffs will bear the burden of proof. On September 7, 1999, the Florida Supreme Court approved the settlement.

As of June 30, 2017, there were 2,346 *Broin II* lawsuits pending in Florida. There have been no *Broin II* trials since 2007.

Class-Action Suits

Overview. As of June 30, 2017, 25 class-action cases, excluding the shareholder cases described below, were pending in the United States against Reynolds Defendants. These class actions seek recovery for personal injuries allegedly caused by cigarette smoking or, in some cases, for economic damages allegedly incurred by cigarette or e-cigarette purchasers.

In 1996, the Fifth Circuit Court of Appeals in *Castano v. American Tobacco Co.* overturned the certification of a nation-wide class of persons whose claims related to alleged addiction to tobacco products, finding that the district court failed to properly assess variations in the governing state laws and whether common issues predominated over individual issues. Since the Fifth Circuit's ruling in *Castano*, few smoker class-action complaints have been certified or, if certified, have survived on appeal. Eighteen federal courts, including two courts of appeals, and most state courts that have considered the issue have rejected class certification in such cases. Apart from *Castano*, only two smoker class actions have been certified by a federal court — *In re Simon (II) Litigation* and *Schwab [McLaughlin] v. Philip Morris USA Inc.*, both of which were filed in the U.S. District Court for the Eastern District of New York and were later decertified.

Class-action suits based on claims that class members are at a greater risk of injury or injured by the use of tobacco or exposure to ETS, or claims that seek primarily economic damages are pending against RJR Tobacco, Lorillard Tobacco, or their affiliates or indemnitees in state or federal courts in California, Florida, Illinois, Louisiana, Missouri, New Mexico, New York, North Carolina and West Virginia. All pending class-action cases are discussed below.

The pending class actions against RJR Tobacco or its affiliates or indemnitees include four cases alleging that the use of the term "lights" constitutes unfair and deceptive trade practices under state law or violates federal RICO. Such suits are pending in state courts in Illinois and Missouri and are discussed below under "— 'Lights' Cases."

E-cigarette class-action cases are pending against RJR Vapor, RAI, and other RAI affiliates in California state and federal courts. In general, the plaintiffs allege that RJR Vapor, Lorillard Tobacco, and other RAI affiliates made false and misleading claims that e-cigarettes are less hazardous than other cigarette products or failed to disclose that e-cigarettes expose users to certain substances. The cases are typically filed pursuant to state consumer protection and related statutes and seek recovery of economic damages and are discussed below under "— E-Cigarette Cases."

Several class actions relating to claims in advertising and promotional materials for SFNTC's NATURAL AMERICAN SPIRIT brand cigarettes are pending in federal courts. In general, these plaintiffs allege that use of the words "natural," "additive-free," or "organic" in NATURAL AMERICAN SPIRIT advertising and promotional materials suggests that those cigarettes are less harmful than other cigarettes and, for that reason, violated state consumer protection statutes or amounted to fraud or a negligent or intentional misrepresentation. These cases are discussed below under "— No Additive/Natural Claim Cases."

Additional class actions relating to alleged personal injuries purportedly caused by use of cigarettes or exposure to ETS are pending. These cases are discussed below under "— Other Class Actions."

Finally, certain third-party payers have filed health-care cost recovery actions in the form of class actions. These cases are discussed separately below under "— Health-Care Cost Recovery Cases."

"Lights" Cases.

As noted above, four "lights" class-action cases are pending against RJR Tobacco or B&W, two in Illinois state court and two in Missouri state court. The classes in these cases generally seek to recover compensatory and punitive damages, injunctive and other forms of relief, and attorneys' fees and costs from RJR Tobacco and/or B&W. In general, the plaintiffs allege that RJR Tobacco or B&W made false and misleading claims that "lights" cigarettes were lower in tar and nicotine and/or were less hazardous or less mutagenic than other cigarettes. The cases typically are filed pursuant to state consumer protection and related statutes.

The seminal "lights" class-action case is *Price v. Philip Morris, Inc*. (Cir. Ct. Madison County, Ill., filed 2000), an action filed against the predecessor of Philip Morris USA Inc., referred to as Philip Morris. In March 2003, the trial court entered judgment against Philip Morris in the amount of $7.1 billion in compensatory damages and $3 billion in punitive damages. In December 2005, the Illinois Supreme Court issued an opinion reversing and remanding with instructions to dismiss the case. On December 5, 2006, the Illinois Supreme Court issued its mandate, and the trial court entered a judgment of dismissal later in December 2006. In multiple filings since December 2008, the *Price* plaintiffs have argued that the U.S. Supreme Court's decision in *Good v. Altria Group, Inc*. rejected the basis upon which the Illinois Supreme Court had reversed the *Price* trial court's 2003 judgment and, on that basis, have attempted to reinstate that judgment. In April 2014, the intermediate appellate court reinstated the trial court's 2003 judgment. In November 2015, the Illinois Supreme Court (1) vacated the lower courts' judgments, (2) dismissed the case without prejudice to allow the plaintiffs to file a motion to have the Illinois Supreme Court recall its December 5, 2006, mandate that had reversed the trial court's 2003

judgment, and (3) directed entry of a judgment of dismissal. The plaintiffs then moved in the Illinois Supreme Court to have that court recall its December 5, 2006 mandate. On January 11, 2016, the Illinois Supreme Court denied the plaintiffs' motion. The plaintiffs filed a petition for writ of certiorari with the U.S. Supreme Court on January 22, 2016, which was denied on June 20, 2016.

In *Turner v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Madison County, Ill., filed 2000), the trial court certified a class of purchasers of RJR Tobacco "lights" cigarettes in November 2001. In November 2003, the Illinois Supreme Court granted RJR Tobacco's motion for a stay pending the court's final appeal decision in the *Price* case described above. The stay subsequently expired, and the court accordingly scheduled a series of status conferences, all of which were continued by agreement of the parties. The status conference scheduled for March 29, 2017 did not occur and has not been rescheduled.

In *Howard v. Brown & Williamson Tobacco Corp.* (Cir. Ct. Madison County, Ill., filed 2000), the trial court certified a class of purchasers of B&W "lights" cigarettes in December 2001. In June 2003, the trial judge issued an order staying all proceedings pending resolution of the *Price* case described above. In August 2005, the Illinois Fifth District Court of Appeals affirmed the Circuit Court's stay order. There is currently no activity in the case.

In *Collora v. R. J. Reynolds Tobacco Co.* (Cir. Ct. City of St. Louis, Mo., filed 2000), the trial court certified a class of purchasers of RJR Tobacco "lights" cigarettes in December 2003. A status conference is scheduled for January 8, 2018.

In *Black v. Brown & Williamson Tobacco Corp.* (Cir. Ct. City of St. Louis, Mo., filed 2000), a putative class action filed on behalf of a class of purchasers of B&W "lights" cigarettes, a status conference is scheduled for January 8, 2018.

In the event RJR Tobacco and its affiliates or indemnitees lose one or more of the pending "lights" class-action suits, RJR Tobacco, depending upon the amount of any damages ordered, could face difficulties in its ability to pay the judgment or obtain any bond required to stay execution of the judgment which could have a material adverse effect on RJR Tobacco's, and consequently RAI's, results of operations, cash flows or financial position.

E-Cigarette Cases.

In *Harris v. R. J. Reynolds Vapor Co.* (U.S.D.C. N.D. Cal., filed 2015), the plaintiff brought a class action against RJR Vapor on behalf of a putative class of purchasers of VUSE e-cigarettes. The plaintiff alleges that RJR Vapor failed to advise users that they potentially could be exposed to formaldehyde and acetaldehyde. The plaintiff asserts failure to warn claims under California's Proposition 65, as well as California Business & Professions Code § 17,200 *et seq*. and California Civil Code § 1,750 *et seq*. and seeks declaratory relief, restitution, disgorgement, injunctive relief and damages. RJR Vapor moved to dismiss contending, among other things, that plaintiff's action was governed in its entirety by Proposition 65 and that the plaintiff failed to give the 60-day pre-suit notice required by Proposition 65, requiring that the entire case be dismissed with prejudice. The motion to dismiss was argued on March 2, 2016. On September 30, 2016, the court granted RJR Vapor's motion to dismiss but provided the plaintiff leave to amend. The plaintiff filed a second amended complaint on October 31, 2016, and RJR Vapor has again moved to dismiss. Oral argument occurred on January 19, 2017. A decision is pending.

No Additive/Natural/Organic Claim Cases.

Following the FDA's August 27, 2015, warning letter to SFNTC relating to the use of the words "natural" and "additive-free" in the labeling, advertising and promotional materials for NATURAL AMERICAN SPIRIT brand cigarettes, plaintiffs purporting to bring claims on behalf of themselves and others have filed putative nationwide and/or state-specific class actions against SFNTC and, in some instances, RAI. A total of 16 such actions have been filed in nine U.S. district courts. Each of these cases is discussed below. In various combinations, plaintiffs in these cases generally allege violations of state deceptive and unfair trade practice statutes, and claim state common law fraud, negligent misrepresentation, and unjust enrichment based on the use of descriptors such as "natural," "organic" and "100% additive-free" in the marketing, labeling, advertising, and promotion of SFNTC's NATURAL AMERICAN SPIRIT brand cigarettes. The actions seek various categories of recovery, including economic damages, injunctive relief (including medical monitoring and cessation programs), interest, restitution, disgorgement, treble and punitive damages, and attorneys' fees and costs.

On January 6, 2016, the plaintiffs in one action filed a motion before the U.S. Judicial Panel on Multidistrict Litigation ("JPML") to consolidate these actions before one district court for pre-trial purposes. On April 11, 2016, the JPML ordered that these cases be consolidated for pre-trial purposes before Judge James O. Browning in the U.S. District Court for the District of New Mexico, referred to as the transferee court, and the then-pending and later-filed cases now are consolidated for pre-trial purposes in that court. The cases that were filed in or transferred for pre-trial purposes to the transferee court are as follows:

- *Sproule v. Santa Fe Natural Tobacco Co., Inc*. (U.S.D.C. S.D. Fla., filed 2015), is an action against SFNTC and RAI on behalf of a putative nationwide class of purchasers of NATURAL AMERICAN SPIRIT brand cigarettes.
- *Brattain v. Santa Fe Natural Tobacco Co., Inc.* (U.S.D.C. N.D. Cal., filed 2015), is an action against SFNTC and RAI on behalf of a putative class of California purchasers of NATURAL AMERICAN SPIRIT brand cigarettes.
- *Rothman v. Santa Fe Natural Tobacco Co., Inc.* (U.S.D.C. S.D.N.Y., filed 2015), is an action against SFNTC and RAI on behalf of a putative class of New York purchasers of NATURAL AMERICAN SPIRIT brand cigarettes.
- *Dunn v. Santa Fe Natural Tobacco Co., Inc.* (U.S.D.C. D.N.M., filed 2015), is an action against SFNTC on behalf of a putative nationwide class (and Minnesota subclass) of purchasers of NATURAL AMERICAN SPIRIT brand cigarettes.
- *Haksal v. Santa Fe Natural Tobacco Co., Inc.* (U.S.D.C. D.N.M., filed 2015), is an action against SFNTC and RAI on behalf of a putative nationwide class (and California, Illinois, Minnesota, and New Mexico subclasses) of purchasers of NATURAL AMERICAN SPIRIT brand cigarettes.
- *Cuebas v. Santa Fe Natural Tobacco Co., Inc.* (U.S.D.C. S.D.N.Y., filed 2016), is an action against SFNTC and RAI on behalf of a putative nationwide class (and New York subclass) of purchasers of NATURAL AMERICAN SPIRIT brand cigarettes.
- *Okstad v. Santa Fe Natural Tobacco Co., Inc.* (U.S.D.C. M.D. Fla., filed 2016), is an action against SFNTC and RAI on behalf of a putative nationwide class and sixteen putative state-based subclasses (Alabama, California, Colorado, Florida, Georgia, Iowa, Illinois, Maryland, Maine, North Carolina, New Jersey, Ohio, Oregon, Pennsylvania, Texas and Wisconsin subclasses) of purchasers of NATURAL AMERICAN SPIRIT brand cigarettes.
- *Ruggiero v. Santa Fe Natural Tobacco Co., Inc.* (U.S.D.C. D.D.C., filed 2016), is an action against SFNTC and RAI on behalf of a putative nationwide class (and Maryland subclass) of purchasers of NATURAL AMERICAN SPIRIT brand cigarettes.
- *Waldo v. Santa Fe Natural Tobacco Co., Inc.* (U.S.D.C. M.D. Fla., filed 2016), is an action against SFNTC and RAI on behalf of a putative nationwide class (and Florida subclass) of purchasers of NATURAL AMERICAN SPIRIT brand cigarettes.
- *Grandison v. Santa Fe Natural Tobacco Co., Inc.* (U.S.D.C. E.D.N.Y., filed 2016), is an action against SFNTC and RAI on behalf of a putative nationwide class (and California, Florida and New York subclasses) of purchasers of NATURAL AMERICAN SPIRIT brand cigarettes.
- *Gudmundson v. Santa Fe Natural Tobacco Co., Inc.* (U.S.D.C. V.I., filed 2016), is an action against SFNTC and RAI on behalf of a putative class of U.S. Virgin Islands purchasers of NATURAL AMERICAN SPIRIT brand cigarettes.
- *LeCompte v. Santa Fe Natural Tobacco Co., Inc.* (U.S.D.C. D.N.M., filed 2016), is an action against SFNTC and RAI on behalf of a putative class of California purchasers of NATURAL AMERICAN SPIRIT brand cigarettes.
- *White v. Santa Fe Natural Tobacco Co., Inc.* (U.S.D.C. D.N.M., filed 2016), is an action against SFNTC on behalf of a putative nationwide class of purchasers of NATURAL AMERICAN SPIRIT brand cigarettes.
- *Johnston v. Santa Fe Natural Tobacco Co., Inc.* (U.S.D.C. S.D Fla., filed 2016), is an action against SFNTC and RAI on behalf of a putative nationwide class (and Florida subclass) of purchasers of NATURAL AMERICAN SPIRIT brand cigarettes.

- *Cole v. Santa Fe Natural Tobacco Co., Inc.* (U.S.D.C. M.D. N.C., filed 2016), is an action against SFNTC and RAI on behalf of a putative nationwide class (and North Carolina subclass) of purchasers of NATURAL AMERICAN SPIRIT brand cigarettes.
- *Hebert v. Santa Fe Natural Tobacco Co., Inc.* (U.S.D.C. M.D. N.C., filed 2016), is an action against SFNTC, RAI and RJR Tobacco on behalf of a putative class of purchasers in California, Colorado, Florida, Illinois, Massachusetts, Michigan, New Jersey, New Mexico, New York, Ohio and Washington of NATURAL AMERICAN SPIRIT cigarettes, and a nationwide putative class of NATURAL AMERICAN SPIRIT brand menthol cigarette purchasers (and subclass of such purchasers in California, Colorado, Florida, Illinois and New Mexico).

The transferee court entered a scheduling order requiring the plaintiffs to file a consolidated amended complaint. On September 19, 2016, the plaintiffs filed a consolidated amended complaint naming SFNTC, RAI, and RJR Tobacco as defendants. That complaint alleges violations of 12 states' deceptive and unfair trade practices statutes — California, Colorado, Florida, Illinois, Massachusetts, Michigan, North Carolina, New Jersey, New Mexico, New York, Ohio, and West Virginia –based on the use of descriptors such as "natural," "organic" and "100% additive-free" in the marketing, labeling, advertising, and promotion of SFNTC's NATURAL AMERICAN SPIRIT brand cigarettes. It also asserts unjust enrichment claims under those 12 states' laws and asserts breach of express warranty claims on behalf of a national class of NATURAL AMERICAN SPIRIT menthol purchasers. The state deceptive and unfair trade practice statutory and unjust enrichment claims are brought on behalf of state-specific classes in the 12 states listed above and, in some instances, state-specific subclasses. The consolidated amended complaint seeks class certification, payment for class notice, injunctive relief, monetary damages, prejudgment interest, statutory damages, restitution, and attorneys' fees and costs. On November 18, 2016, the defendants filed a motion to dismiss. Before responding to the motion to dismiss, the plaintiffs filed a second amended class action complaint on January 12, 2017. On February 23, 2017, the defendants moved to dismiss the second amended complaint. Oral argument on the defendants' motion to dismiss commenced on June 9, 2017 and is now completed. A decision is pending. The transferee court's scheduling order, as amended, provides for the plaintiffs to file a motion for class certification by April 3, 2018, and a hearing on the class certification motion on July 13-14, 2018.

On November 7, 2016, a public health advocacy organization filed *Breathe DC v. Santa Fe Natural Tobacco Co., Inc*. (D.C. Super. Ct.), an action against SFNTC, RAI and RJR Tobacco based on allegations relating to the labeling, advertising and promotional materials for NATURAL AMERICAN SPIRIT brand cigarettes that are similar to the allegations in the actions consolidated for pre-trial purposes in the transferee court described immediately above. The complaint seeks injunctive and other non-monetary relief, but does not seek monetary damages. On December 6, 2016, the defendants removed the action to the U.S. District Court for the District of Columbia and, on December 7, 2016, filed a notice with the JPML to have the action transferred to the transferee court. On December 7, 2016, the plaintiff moved in the U.S. District Court for the District of Columbia to remand the action to the Superior Court for the District of Columbia. On February 14, 2017, the U.S. District Court for the District of Columbia granted the plaintiffs' motion to remand, and the case was remanded to the Superior Court of the District of Columbia. On June 9, 2017, the defendants moved to dismiss, and the court entered an order providing for briefing on that motion to conclude by August 29, 2017.

Other Class Actions.

In *Young v. American Tobacco Co., Inc.* (Cir. Ct. Orleans Parish, La., filed 1997), the plaintiff brought a class action against U.S. cigarette manufacturers, including RJR Tobacco and B&W, and parent companies of U.S. cigarette manufacturers, including RJR, on behalf of a putative class of Louisiana residents who, though not themselves cigarette smokers, allegedly suffered injury as a result of exposure to ETS from cigarettes manufactured by defendants. The plaintiffs seek to recover an unspecified amount of compensatory and punitive damages. In March 2016, the court entered an order staying the case, including all discovery, pending the completion of the smoking cessation program ordered by the court in *Scott v. The American Tobacco Co*.

In *Parsons v. A C & S, Inc.* (Cir. Ct. Ohio County, W. Va., filed 1998), the plaintiff brought a class action against asbestos manufacturers, U.S. cigarette manufacturers, including RJR Tobacco, B&W, Lorillard Tobacco, and parent companies of U.S. cigarette manufacturers, including RJR and Lorillard, on behalf of a putative class of persons who allegedly have personal injury claims arising from their exposure to respirable asbestos fibers and cigarette smoke. The plaintiff seeks to recover $1 million in compensatory and punitive damages individually for her purported injuries and an unspecified amount for the class in compensatory and punitive damages. In December 2000, three defendants, Nitral Liquidators, Inc., Desseaux Corporation of North America and

Armstrong World Industries, filed bankruptcy petitions in the U.S. Bankruptcy Court for the District of Delaware, *In re Armstrong World Industries, Inc.* Pursuant to section 362(a) of the Bankruptcy Code, *Parsons* is automatically stayed with respect to all defendants who filed for bankruptcy. The case remains pending against the other defendants, including RJR Tobacco and Lorillard Tobacco, but it has long been dormant.

In *Jones v. American Tobacco Co., Inc.* (Cir. Ct., Jackson County, Mo., filed 1998), the plaintiff filed a class action against the major U.S. cigarette manufacturers, including RJR Tobacco, B&W, Lorillard Tobacco, and parent companies of U.S. cigarette manufacturers, including RJR and Lorillard, on behalf of a putative class of Missouri tobacco product users and purchasers who allegedly became addicted to nicotine. The plaintiffs seek an unspecified amount of compensatory and punitive damages. There is currently no activity in this case.

Filter Cases

Claims have been brought against Lorillard Tobacco and Lorillard by individuals who seek damages resulting from their alleged exposure to asbestos fibers that were incorporated into filter material used in one brand of cigarettes manufactured by a predecessor to Lorillard Tobacco for a limited period of time ending more than 50 years ago. As of June 30, 2017, Lorillard Tobacco and/or Lorillard was a defendant in 73 Filter Cases. Since January 1, 2014, Lorillard Tobacco and RJR Tobacco have paid, or have reached agreement to pay, a total of approximately $42.3 million in settlements to resolve 165 Filter Cases.

Pursuant to the terms of a 1952 agreement between P. Lorillard Company and H&V Specialties Co., Inc. (the manufacturer of the filter material), Lorillard Tobacco is required to indemnify Hollingsworth & Vose for legal fees, expenses, judgments and resolutions in cases and claims alleging injury from finished products sold by P. Lorillard Company that contained the filter material.

On September 13, 2013, the jury in a Filter Case, *DeLisle v. A. W. Chesterton Co.* (Cir. Ct. Broward County, Fla., filed 2012), found for the plaintiffs on the negligence and strict liability claims; awarded the plaintiffs $8 million in compensatory damages; and found Lorillard Tobacco 22% at fault, Hollingsworth & Vose 22% at fault, and the other defendants 56% at fault. Punitive damages were not at issue. On November 6, 2013, the trial court entered final judgment against Lorillard Tobacco in the amount of $3.52 million. Lorillard Tobacco appealed to the Fourth DCA. On September 14, 2016, the Fourth DCA ordered a new trial because the trial court erred in admitting certain expert testimony and concluded that the $8 million compensatory damages award should have been remitted. On July 7, 2017, the Florida Supreme Court granted the plaintiff's motion and stayed proceedings in the Fourth DCA and in the trial court, pending disposition of the petition for discretionary review, and it accepted jurisdiction and granted review on July 11, 2017. Oral argument has not been scheduled.

Health-Care Cost Recovery Cases

Health-care cost recovery cases have been brought by a variety of plaintiffs. Other than certain governmental actions, these cases largely have been unsuccessful on remoteness grounds, which means that one who pays an injured person's medical expenses is legally too remote to maintain an action against the person allegedly responsible for the injury.

As of June 30, 2017, two health-care cost recovery cases were pending in the United States against RJR Tobacco, B&W, Lorillard Tobacco, or all three, as discussed below after the discussion of the State Settlement Agreements. A limited number of claimants have filed suit against RJR Tobacco, one of its affiliates, and other tobacco industry defendants to recover funds for health care, medical and other assistance paid by foreign provincial governments in treating their citizens. For additional information on these cases, see "— International Cases" below.

State Settlement Agreements. In June 1994, the Mississippi Attorney General brought an action, *Moore v. American Tobacco Co.*, against various industry members, including RJR Tobacco, B&W and Lorillard Tobacco. This case was brought on behalf of the state to recover state funds paid for health care and other assistance to state citizens suffering from diseases and conditions allegedly related to tobacco use. Most other states, through their attorneys general or other state agencies, sued RJR Tobacco, B&W, Lorillard Tobacco and other U.S. cigarette manufacturers based on similar theories. The cigarette manufacturer defendants, including RJR Tobacco, B&W and Lorillard Tobacco, settled the first four of these cases scheduled for trial — Mississippi, Florida, Texas and Minnesota — by separate agreements with each such state.

On November 23, 1998, the major U.S. cigarette manufacturers, including RJR Tobacco, B&W and Lorillard Tobacco, entered into the Master Settlement Agreement with attorneys general representing the remaining 46 states, the District of Columbia, Puerto Rico, Guam, the Virgin Islands, American Samoa and the Northern Marianas. Effective on November 12, 1999, the MSA settled all the health-care cost recovery actions brought by, or on behalf of, the settling jurisdictions and released various additional present and future claims.

In the settling jurisdictions, the MSA released RJR Tobacco, B&W, Lorillard Tobacco, and their affiliates and indemnitees, including RAI and Lorillard, from:

- all claims of the settling states and their respective political subdivisions and other recipients of state health-care funds, relating to past conduct arising out of the use, sale, distribution, manufacture, development, advertising, marketing or health effects of, the exposure to, or research, statements or warnings about, tobacco products; and
- all monetary claims of the settling states and their respective political subdivisions and other recipients of state health-care funds, relating to future conduct arising out of the use of or exposure to, tobacco products that have been manufactured in the ordinary course of business.

Set forth below is the unadjusted tobacco industry settlement payment schedule (in millions) for 2015 and thereafter:

	2015 and thereafter
First Four States' Settlements: (1)	
Mississippi Annual Payment	$ 136
Florida Annual Payment	440
Texas Annual Payment	580
Minnesota Annual Payment	204
Master Settlement Agreement:	
Annual Payments (1)	8,004
Total	$9,364

RAI's operating subsidiaries expenses and payments under the State Settlement Agreements for 2015, 2016 and the projected expenses and payments for 2017 and thereafter (in millions) are set forth below. (1)(2)

	2015	2016	2017	2018 and thereafter
Settlement expenses	$2,403	$2,727	—	—
Settlement cash payments	$2,166	$3,042	—	—
Projected settlement expenses			$>3,000	$>3,000
Projected settlement cash payments			$>2,700	$>3,000

(1) Subject to adjustments for changes in sales volume, inflation, operating profit and other factors. Payments are allocated among the companies on the basis of relative market share or other methods. For further information, see "— State Settlement Agreements — Enforcement and Validity; Adjustments" below.

(2) The amounts above reflect the impact of the Term Sheet and the NY State Settlement described below under "— State Settlement Agreements — Enforcement and Validity; Adjustments — Partial Settlement of Certain NPM Adjustment Claims."

The State Settlement Agreements also contain provisions restricting the marketing of tobacco products. Among these provisions are restrictions or prohibitions on the use of cartoon characters, brand-name sponsorships, apparel and other merchandise, outdoor and transit advertising, payments for product placement, free sampling and lobbying. Furthermore, the State Settlement Agreements required the dissolution of three industry-sponsored research and trade organizations.

The State Settlement Agreements have materially adversely affected RJR Tobacco's shipment volumes. RAI believes that these settlement obligations may materially adversely affect the results of operations, cash flows or financial position of RAI and RJR Tobacco in future periods. The degree of the adverse impact will depend, among other things, on the rate of decline in U.S. cigarette sales in the premium and value categories, RJR Tobacco's share of the domestic premium and value cigarette categories, and the effect of any resulting cost advantage of manufacturers not subject to the State Settlement Agreements.

U.S. Department of Justice Case.

In *United States v. Philip Morris USA Inc.* (U.S.D.C. D.D.C., filed 1999), the U.S. Department of Justice brought an action against RJR Tobacco, B&W, Lorillard Tobacco and other tobacco companies seeking (1) recovery of federal funds expended in providing health care to smokers who developed alleged smoking-related diseases pursuant to the Medical Care Recovery Act and Medicare Secondary Payer provisions of the Social Security Act and (2) equitable relief under the civil provisions of RICO, including disgorgement of roughly $280 billion in profits the government contended were earned as a consequence of a purported racketeering "enterprise." In September 2000, the district court dismissed the government's Medical Care Recovery Act and Medicare Secondary Payer claims. In February 2005, the U.S. Court of Appeals for the D.C. Circuit, referred to as the D.C. Circuit, ruled that disgorgement was not an available remedy.

On August 17, 2006, after a non-jury bench trial, the district court found certain defendants, including RJR Tobacco, B&W and Lorillard Tobacco, had violated RICO, but did not impose any direct financial penalties. The district court instead enjoined RJR Tobacco, Lorillard Tobacco and the other defendants from committing future racketeering acts, participating in certain trade organizations, making misrepresentations concerning smoking and health and youth marketing, and using certain brand descriptors such as "low tar," "light," "ultra light," "mild" and "natural." The district court also ordered RJR Tobacco, Lorillard Tobacco and the other defendants to issue "corrective communications" on five subjects, including smoking and health and addiction, and to comply with further undertakings, including maintaining web sites of historical corporate documents and disseminating certain marketing information on a confidential basis to the government. In addition, the district court placed restrictions on the defendants' ability to dispose of certain assets for use in the United States, unless the transferee agrees to abide by the terms of the district court's order, and ordered certain defendants to reimburse the U.S. Department of Justice its taxable costs incurred in connection with the case.

Defendants, including RJR Tobacco, B&W, and Lorillard Tobacco, appealed, the government cross appealed, and the defendants moved in the district court for clarification and a stay pending appeal. After the district court denied the defendants' motion to stay, the D.C. Circuit granted a stay in October 2006.

The district court then granted the motion for clarification in part and denied it in part. With respect to the meaning and applicability of the general injunctive relief of the August 2006 order, the district court denied the motion for clarification. With respect to the request for clarification as to the scope of the provisions in the order prohibiting the use of descriptors and requiring corrective statements at retail point of sale, the district court granted the motion and also ruled that the provisions prohibiting the use of express or implied health messages or descriptors do apply to the actions of the defendants taken outside of the United States.

In May 2009, the D.C. Circuit largely affirmed both the finding of liability against the tobacco defendants and the remedial order, including the denial of additional remedies, but vacated the order and remanded for further proceedings as to the following four discrete issues:

- the issue of the extent of B&W's control over tobacco operations was remanded for further fact finding and clarification;
- the remedial order was vacated to the extent that it binds all defendants' subsidiaries and was remanded to the district court for determination as to whether inclusion of the subsidiaries and which of the subsidiaries satisfy Rule 65(d) of the Federal Rules of Civil Procedure;
- the D.C. Circuit held that the provision found in paragraph four of the injunction, concerning the use of any express or implied health message or health descriptor for any cigarette brand, should not be read to govern overseas sales. The issue was remanded to the district court with instructions to reformulate it so as to exempt foreign activities that have no substantial, direct and foreseeable domestic effects; and
- the remedial order was vacated regarding "point of sale" displays and remanded for the district court to evaluate and make due provisions for the rights of innocent persons, either by abandoning this part of the remedial order or re-crafting a new version reflecting the rights of third parties.

In June 2010, the U.S. Supreme Court denied all parties' petitions for writ of certiorari.

Post-remand proceedings are underway. On December 22, 2010, the district court dismissed B&W from the litigation. In November 2012, the trial court entered an order setting forth the text of the corrective statements and directed the parties to engage in discussions with the Special Master to implement them. After extensive mediation led the parties to an implementation agreement, the district court entered an implementation order on

June 2, 2014. The defendants filed a consolidated appeal challenging both the content of the court-ordered statements and the requirement that those statements be published in redundant media. On May 22, 2015, the D.C. Circuit reversed the corrective statements order in part, affirmed in part, and remanded to the district court for further proceedings. On October 1, 2015, the district court ordered the parties to propose new corrective-statements preambles. On February 8, 2016, the district court entered an order adopting the government's proposed corrective-statements preamble. The parties then mediated, per the district court's order, changes to the implementation order necessitated by the new preamble. On April 19, 2016, the district court accepted the parties' mediated agreement on implementation and entered a superseding consent order with respect to implementation. The superseding consent order stays implementation of the corrective statements until the exhaustion of appeals from the orders establishing the text of those statements and governing implementation details. On April 7, 2016, the defendants and the post-judgment parties regarding remedies noticed an appeal to the D.C. Circuit from the order adopting the government's proposed corrective-statement preambles. On May 6, 2016, the defendants and post-judgment parties regarding remedies noticed an appeal to the D.C. Circuit from the superseding consent order. On June 7, 2016, the D.C. Circuit granted the unopposed motion of the defendants and the post-judgment parties regarding remedies to consolidate the two appeals. Briefing in the consolidated appeals concluded in late December 2016, and oral argument occurred on February 14, 2017. On April 25, 2017, the D.C. Circuit affirmed in part, reversed in part, and remanded for further proceedings. The court has not yet set a schedule for the proceedings on remand. Additionally, RJR Tobacco appealed the district court's May 28, 2015, order requiring RJR Tobacco to televise an additional set of corrective statements on behalf of B&W. On November 1, 2016, the D.C. Circuit upheld the order. In light of the corrective-statements implementation requirements, $20 million has been accrued for the estimated costs of the corrective communications and is included in the condensed consolidated balance sheet (unaudited) as of June 30, 2017.

Native American Tribe Case.

As of June 30, 2017, one Native American tribe case was pending before a tribal court against RJR Tobacco, B&W and Lorillard Tobacco, *Crow Creek Sioux Tribe v. American Tobacco Co.* (Tribal Ct., Crow Creek Sioux, S.D., filed 1997). The plaintiffs seek to recover actual and punitive damages, restitution, funding of a clinical cessation program, funding of a corrective public education program, and disgorgement of unjust profits from sales to minors. The plaintiffs claim that the defendants are liable under the following theories: unlawful marketing and targeting of minors, contributing to the delinquency of minors, unfair and deceptive acts or practices, unreasonable restraint of trade and unfair method of competition, negligence, negligence per se, conspiracy and restitution of unjust enrichment. The case is dormant.

International Cases.

Each of the ten Canadian provinces has filed a health-care cost recovery action against Canadian and non-Canadian tobacco-related entities, including RJR Tobacco and one of its affiliates. In these actions, which are described below, each of the Canadian provinces seeks to recover for health care, medical and other assistance paid and to be paid for treating tobacco-related disease. Pursuant to the terms of the 1999 sale of RJR Tobacco's international tobacco business, RJR Tobacco has tendered the defense of these actions to JTI. Subject to a reservation of rights, JTI has assumed the defense of RJR Tobacco and its affiliate in these actions.

- *British Columbia* (British Columbia Sup. Ct., Vancouver Registry, filed 1997) — In 1997, British Columbia enacted a statute creating a civil cause of action against tobacco-related entities for the provincial government to recover the costs of health-care benefits incurred for insured British Columbia residents resulting from tobacco-related disease. An initial action brought pursuant to the statute against Canadian and non-Canadian tobacco-related entities, including RJR Tobacco and certain of its affiliates, was dismissed in February 2000 when the British Columbia Supreme Court ruled that the legislation was unconstitutional. British Columbia then enacted a revised statute, pursuant to which an action was filed in January 2001 against many of the same defendants, including RJR Tobacco and one of its affiliates. In that action, the British Columbia government seeks to recover the present value of its total expenditures for health-care benefits provided for insured persons resulting from tobacco-related disease or the risk of tobacco-related disease caused by alleged breaches of duty by the manufacturers, the present value of its estimated total expenditures for health-care benefits that reasonably could be expected to be provided for those insured persons resulting from tobacco-related disease or the risk of tobacco-related disease in the future, court ordered interest, and costs, or in the alternative, special or increased costs. The government alleges that the defendants are liable under the British Columbia statute by reason of their "tobacco related wrongs," which are alleged to include: selling defective products, failure to warn, sale of cigarettes to children and adolescents, strict liability,

deceit and misrepresentation, violation of trade practice and competition acts, concerted action, and joint liability. RJR Tobacco and its affiliate filed statements of defense in January 2007. Pre-trial discovery is ongoing.

- *New Brunswick* (Ct. of Queen's Bench of New Brunswick, Jud. Dist. Fredericton, filed 2008) — This claim is brought pursuant to New Brunswick legislation enacted in 2008 that is substantially similar to the revised British Columbia statute described above. It seeks recovery of essentially the same types of damages sought in the British Columbia action based on analogous theories of liability. RJR Tobacco and its affiliate filed statements of defense in March 2010. Pre-trial discovery is ongoing. Trial has been set to begin on November 4, 2019.

- *Ontario* (Ontario Super. Ct. Justice, Toronto, filed 2009) — This claim is brought pursuant to Ontario legislation that is substantially similar to the revised British Columbia statute described above. It seeks recovery of essentially the same types of damages sought in the British Columbia action based on analogous theories of liability, although the government also asserted claims based on the illegal importation of cigarettes, which claims were deleted in an amended statement of claim filed in August 2010. RJR Tobacco and its affiliate filed statements of defense in April 2016.

- *Newfoundland and Labrador* (Sup. Ct. Newfoundland and Labrador, St. John's, filed 2011) — This claim is brought pursuant to Newfoundland and Labrador legislation that is substantially similar to the revised British Columbia statute described above. It seeks recovery of essentially the same types of damages sought in the British Columbia action based on analogous theories of liability. RJR Tobacco and its affiliate filed statements of defense in May 2016.

- *Manitoba* (Ct. of Queen's Bench, Winnipeg Jud. Centre, filed 2012) — This claim is brought pursuant to Manitoba legislation that is substantially similar to the revised British Columbia statute described above. It seeks recovery of essentially the same types of damages sought in the British Columbia action based on analogous theories of liability. RJR Tobacco and its affiliate filed statements of defense in September 2014. Pre-trial discovery is ongoing.

- *Quebec* (Super. Ct. Quebec, Dist. Montreal, filed 2012) — This claim is brought pursuant to Quebec legislation that is substantially similar to the revised British Columbia statute described above. It seeks recovery of essentially the same types of damages being sought in the British Columbia action based on analogous theories of liability. RJR Tobacco and its affiliate filed defenses in December 2014. Pre-trial discovery is ongoing.

- *Saskatchewan* (Ct. of Queen's Bench, Jud. Centre Saskatoon, filed 2012) — This claim is brought pursuant to Saskatchewan legislation that is substantially similar to the revised British Columbia statute described above. It seeks recovery of essentially the same types of damages sought in the British Columbia action based on analogous theories of liability. RJR Tobacco and its affiliate filed statements of defense in February 2015.

- *Alberta* (Ct. of Queen's Bench, Alberta Jud. Centre of Calgary, filed 2012) — This claim is brought pursuant to Alberta legislation that is substantially similar to the revised British Columbia statute described above. It seeks recovery of essentially the same types of damages sought in the British Columbia action based on analogous theories of liability. RJR Tobacco and its affiliate filed statements of defense in March 2016.

- *Prince Edward Island* (Sup. Ct. P.E.I., Charlottetown, filed 2012) — This claim is brought pursuant to Prince Edward Island legislation that is substantially similar to the revised British Columbia statute described above. It seeks recovery of essentially the same types of damages sought in the British Columbia action based on analogous theories of liability. RJR Tobacco and its affiliate filed statements of defense in February 2015.

- *Nova Scotia* (Sup. Ct. Nova Scotia, Halifax, filed 2015) — This claim is brought pursuant to Nova Scotia legislation that is substantially similar to the revised British Columbia statute described above. It seeks recovery of essentially the same types of damages sought in the British Columbia action based on analogous theories of liability. RJR Tobacco and its affiliate filed statements of defense in July 2015.

Seven putative class actions, which are described below, have been filed against various Canadian and non-Canadian tobacco-related entities, including RJR Tobacco and one of its affiliates, in Canadian provincial courts. In these cases, the plaintiffs allege claims based on fraud, fraudulent concealment, breach of warranty,

breach of warranty of merchantability, and of fitness for a particular purpose, failure to warn, design defects, negligence, breach of a "special duty" to children and adolescents, conspiracy, concert of action, unjust enrichment, market share liability, and violations of various trade practices and competition statutes. The plaintiffs seek recovery on behalf of proposed classes of persons allegedly suffering from tobacco-related disease as a result of smoking defendants' cigarettes and seek recovery of compensatory and punitive damages, restitution, recovery of government health-care benefits, interest, and costs. Pursuant to the terms of the 1999 sale of RJR Tobacco's international tobacco business, RJR Tobacco has tendered the defense of these seven actions to JTI. Subject to a reservation of rights, JTI has assumed the defense of RJR Tobacco and its current or former affiliates in these actions. Plaintiffs' counsel have been actively pursuing only *Bourassa*, the action pending in British Columbia, at this time.

- In *Kunka v. Canadian Tobacco Manufacturers' Council* (Ct. of Queen's Bench, Winnipeg Jud. Centre, filed 2009), the plaintiff seeks compensatory and punitive damages on behalf of a proposed class of persons who purchased or smoked defendants' cigarettes and suffered, or currently suffer, from tobacco-related disease, as well as restitution of profits and reimbursement of government expenditure for health-care benefits allegedly caused by the use of tobacco products.

- In *Dorion v. Canadian Tobacco Manufacturers' Council* (Ct. of Queen's Bench, Alberta Jud. Centre of Calgary — filed 2009), the plaintiff seeks compensatory and punitive damages on behalf of a proposed class of persons who purchased or smoked defendants' cigarettes and suffered, or currently suffer, from tobacco-related disease, as well as restitution of profits and reimbursement of government expenditure for health-care benefits allegedly caused by the use of tobacco products.

- In *Semple v. Canadian Tobacco Manufacturers' Council* (Sup. Ct. Nova Scotia, Halifax, filed 2009), the plaintiff seeks compensatory and punitive damages on behalf of a proposed class comprised of persons who purchased or smoked defendants' cigarettes for the period from January 1, 1954, to the expiry of the opt-out period as set by the court and suffered, or currently suffer, from tobacco-related disease, as well as restitution of profits and reimbursement of government expenditure for health-care costs allegedly caused by the use of tobacco products.

- In *Adams v. Canadian Tobacco Manufacturers' Council* (Ct. of Queen's Bench, Jud. Centre of Regina, filed 2009), the plaintiff seeks compensatory and punitive damages on behalf of a proposed class of persons who were alive on July 10, 2009, and suffered, or currently suffer, from chronic obstructive pulmonary disease, emphysema, heart disease or cancer, after having smoked a minimum of 25,000 of defendants' cigarettes, as well as disgorgement of revenues earned by the defendants. RJR Tobacco and its affiliate have brought a motion challenging the jurisdiction of the Saskatchewan court.

- In *Bourassa v. Imperial Tobacco Canada Ltd.* (Sup. Ct. of British Columbia, Victoria Registry, filed 2010), the plaintiff seeks compensatory and punitive damages on behalf of a proposed class of persons who were alive on June 12, 2007, and suffered, or currently suffer, from chronic respiratory diseases, after having smoked a minimum of 25,000 of defendants' cigarettes, as well as disgorgement of revenues earned by the defendants from January 1, 1954, to the date the claim was filed. RJR Tobacco and its affiliate have filed a challenge to the jurisdiction of the British Columbia court. The plaintiff filed a motion for certification in April 2012, and filed affidavits in support in August 2013. An amended claim was filed in December 2014.

- In *McDermid v. Imperial Tobacco Canada Ltd.* (Sup. Ct. of British Columbia, Victoria Registry, filed 2010), the plaintiff seeks compensatory and punitive damages on behalf of a proposed class of persons who were alive on June 12, 2007, and suffered, or currently suffer, from heart disease, after having smoked a minimum of 25,000 of defendants' cigarettes, as well as disgorgement of revenues earned by the defendants from January 1, 1954, to the date the claim was filed. RJR Tobacco and its affiliate have filed a challenge to the jurisdiction of the British Columbia court.

- In *Jacklin v. Canadian Tobacco Manufacturers' Council* (Ontario Super. Ct. of Justice, St. Catherines, filed 2012), the plaintiff seeks compensatory and punitive damages on behalf of a proposed class of persons who were alive on June 12, 2007, and suffered, or currently suffer, from chronic obstructive pulmonary disease, heart disease, or cancer, after having smoked a minimum of 25,000 of defendants' cigarettes, as well as restitution of profits, and reimbursement of government expenditure for health-care benefits allegedly caused by the use of tobacco products.

State Settlement Agreements — Enforcement and Validity; Adjustments

As of June 30, 2017, there were two cases concerning the enforcement, validity or interpretation of the State Settlement Agreements in which RJR Tobacco, B&W or Lorillard Tobacco is a party. This number includes the motion to enforce, discussed below, relating to disputed payments under the State Settlement Agreements.

In May 2006, the State of Florida filed a motion, in the Circuit Court of the Fifteenth Judicial Circuit, in and for Palm Beach County, Florida, to enforce the Florida settlement agreement, referred to as the Florida Settlement Agreement, for an accounting by B&W and for an Order of Contempt. The State asserted that B&W failed to report in its net operating profit on its shipments, cigarettes manufactured by B&W under contract for Star Tobacco or its parent, Star Scientific, Inc. The State is seeking approximately $12.4 million in additional payments under the Florida Settlement Agreement, as well as $17.0 million in interest payments. This matter is currently in the discovery phase.

On January 18, 2017, the State of Florida filed a motion to enjoin ITG as a defendant and to enforce the Florida Settlement Agreement. The State's motion seeks payment under the Florida Settlement Agreement with respect to the four brands (WINSTON, SALEM, KOOL and MAVERICK) that were sold to ITG in the Divestiture. Under the asset purchase agreement relating to the Divestiture (and related documents), ITG was to assume responsibility with respect to these brands. Since the closing of the Divestiture and the transfer of these brands to it, ITG has not made settlement payments to the State with respect to these brands. The State's motion asserts that it "is presently owed more than $45 million and will continue to suffer annual losses of approximately $30 million absent the Court's enforcement of the Settlement Agreement…." The State's motion seeks, among other things, an order from the court declaring that RJR Tobacco and ITG are in breach of the Florida Settlement Agreement and are required, jointly and severally, to make annual payments to the State under the Florida Settlement Agreement with respect to the brands transferred to ITG in the Divestiture.

Also on January 18, 2017, Philip Morris USA, Inc. filed a motion to enforce the Florida Settlement Agreement. Philip Morris USA, Inc.'s motion asserted that RJR Tobacco and ITG have breached the Florida Settlement Agreement by failing to comply with the obligations under the Florida Settlement Agreement with respect to the transferred brands. Philip Morris USA, Inc.'s motion asserts that RJR Tobacco and ITG have "…deprived the State…of over $40 million in settlement payments and improperly shifted millions of the remaining settlement payment obligations from themselves to Philip Morris USA, Inc., amounts that will increase greatly going forward absent intervention by [the] Court." Philip Morris USA, Inc.'s motion seeks various forms of relief to modify the settlement payment calculations to address the issues raised in its motion.

On January 27, 2017, RJR Tobacco filed a motion asserting that ITG failed to use its reasonable best efforts to join the Florida Settlement Agreement and breached the asset purchase agreement relating to the Divestiture. Accordingly, RJR Tobacco filed a motion for leave to allow a supplemental pleading for breach by ITG of its obligations regarding joinder into the Florida Settlement Agreement.

On March 30, 2017, the Florida court ruled that ITG should be joined into the enforcement action. Discovery related to the various motions is now underway. Court ordered mediation occurred on July 17, 2017, and the parties did not reach a resolution.

On February 17, 2017, ITG filed a complaint in the Court of Chancery of the State of Delaware seeking declaratory relief and a motion for a temporary restraining order against RAI and RJR Tobacco. In its complaint, ITG asked the court to declare various matters related to its rights and obligations under the asset purchase agreement (and related documents). In its motion, ITG asked for an injunction barring RAI and/or RJR Tobacco from alleging in the Florida enforcement litigation that ITG had breached the asset purchase agreement and requiring these companies to litigate issues under the asset purchase agreement in Delaware. A hearing was held on ITG's complaint and motion on March 1, 2017. After argument, the court entered a temporary restraining order that enjoined RAI and RJR Tobacco from "taking offensive action to assert claims against ITG Brands" in the Florida enforcement action, but the order does not prevent RJR Tobacco from making arguments in response to claims asserted by the State of Florida, Philip Morris USA, Inc. or ITG in the Florida enforcement litigation. On March 24, 2017, RAI and RJR Tobacco answered the ITG complaint and filed a motion to stay proceedings in Delaware pending the outcome of the Florida enforcement litigation. The motion for stay filed by RAI and RJR Tobacco was denied on May 18, 2017. Cross motions for partial judgment on the pleadings were filed focusing on whether ITG's obligation to use "reasonable best efforts" to join the Florida Settlement continued after the June 12, 2015 closing. Briefing is in progress, and oral argument on the cross motions has been scheduled for September 8, 2017.

NPM Adjustment Claims. The MSA includes an adjustment that potentially reduces the annual payment obligations of RJR Tobacco, Lorillard Tobacco and the other PMs. Certain requirements, collectively referred to as the Adjustment Requirements, must be satisfied before the NPM Adjustment for a given year is available:

- an Independent Auditor must determine that the PMs have experienced a market share loss, beyond a triggering threshold, to those manufacturers that do not participate in the MSA, such non-participating manufacturers referred to as NPMs; and
- in a binding arbitration proceeding, a firm of independent economic consultants must find that the disadvantages of the MSA were a significant factor contributing to the loss of market share. This finding is known as a significant factor determination.

When the Adjustment Requirements are satisfied, the MSA provides that the NPM Adjustment applies to reduce the annual payment obligation of the PMs. However, an individual settling state may avoid its share of the NPM Adjustment if it had in place and diligently enforced during the entirety of the relevant year a "Qualifying Statute" that imposes escrow obligations on NPMs that are comparable to what the NPMs would have owed if they had joined the MSA. In such event, the state's share of the NPM Adjustment is reallocated to other settling states, if any, that did not have in place and diligently enforce a Qualifying Statute.

NPM Adjustment Claim for 2003. For 2003, the Adjustment Requirements were satisfied. As a result, based on revised numbers calculated by the Independent Auditor, RJR Tobacco placed approximately $615 million, and Lorillard Tobacco placed approximately $109 million, of its 2006 and 2007 MSA payments into a disputed payments account, in accordance with a procedure established by the MSA.

As a result of this action, 37 of the settling states filed legal proceedings in their respective MSA courts seeking declaratory orders that they diligently enforced their Qualifying Statutes during 2003 and/or orders compelling RJR Tobacco and the other PMs that placed money in the disputed payments account to pay the disputed amounts to the settling states. In response, RJR Tobacco and other PMs, pursuant to the MSA's arbitration provisions, moved to compel arbitration of the parties' dispute concerning the 2003 NPM Adjustment, including the states' diligent enforcement claims, before an arbitration panel consisting of three retired federal court judges. The settling states opposed these motions, arguing, among other things, that the issue of diligent enforcement must be resolved by MSA courts in each of the 52 settling states and territories.

Forty-seven of the 48 courts that addressed the question whether the dispute concerning the 2003 NPM Adjustment is arbitrable ruled that arbitration was required under the MSA. The Montana Supreme Court ruled that the State of Montana did not agree to arbitrate the question of whether it diligently enforced a Qualifying Statute. Subsequently, Montana and the PMs reached an agreement whereby the PMs agreed not to contest Montana's claim that it diligently enforced the Qualifying Statute during 2003.

In January 2009, RJR Tobacco and certain other PMs entered into an Agreement Regarding Arbitration, referred to as the Arbitration Agreement, with 45 of the MSA settling states (representing approximately 90% of the allocable share of the settling states) pursuant to which those states agreed to participate in a multistate arbitration of issues related to the 2003 NPM Adjustment. Under the Arbitration Agreement, the signing states had their ultimate liability, if any, with respect to the 2003 NPM Adjustment reduced by 20%, and RJR Tobacco and the other PMs that placed their share of the disputed 2005 NPM Adjustment (discussed below) into the disputed payments account, without releasing or waiving any claims, authorized the release of those funds to the settling states.

The arbitration panel contemplated by the MSA and the Arbitration Agreement was selected, and proceedings before the panel with respect to the 2003 NPM Adjustment claim began in July 2010. Following the completion of document and deposition discovery, on November 3, 2011, RJR Tobacco and the other PMs advised the Arbitration Panel that they were not contesting the "diligent enforcement" of 12 states and the four U.S. territories with a combined allocable share of less than 14%. The "diligent enforcement" of the remaining 33 settling states, the District of Columbia and Puerto Rico was contested and became the subject of further proceedings. A common issues hearing was held in April 2012, and state specific evidentiary hearings with respect to the contested states were initiated.

As a result of the partial settlement of certain NPM Adjustment claims, as described in more detail below, as well as the earlier decisions not to contest the diligent enforcement of 12 states, two of which are participants in the partial settlement, and the four U.S. territories, only 15 contested settling states required state specific diligent enforcement rulings. State specific evidentiary hearings were completed in May 2013.

In September 2013, the Arbitration Panel issued rulings with respect to the 15 remaining contested states. The Arbitration Panel ruled that six states — Indiana, Kentucky, Maryland, Missouri, New Mexico and

Pennsylvania (collectively representing approximately 14.68% allocable share) — had not diligently enforced their Qualifying Statutes in 2003. Each of these six states filed motions to vacate and/or modify the diligent enforcement rulings on the 2003 NPM Adjustment claim. The status of the remaining pending motion is as follows:

- New Mexico filed motions challenging the finding of non-diligence and seeking a modification of the judgment reduction method adopted by the Arbitration Panel. The New Mexico trial court denied the state's motion to vacate the finding of non-diligence, but granted the state's motion challenging the judgment reduction method that had been adopted by the Arbitration Panel, which reduced RJR Tobacco's and Lorillard Tobacco's recovery from this state by $5.6 million and $1 million, respectively. RJR Tobacco has appealed the court's ruling on the judgment reduction method. The State did not appeal the trial court's denial of its motion to vacate the finding on non-diligence.

The effect from the four non-diligent states, Pennsylvania, Missouri, Maryland and New Mexico, no longer challenging the findings of non-diligence entered against them by the Arbitration Panel was that a certain portion of the potential recovery from these four states was probable and reasonably estimable. Consequently, $6 million and $93 million was recognized as a reduction of cost of products sold in RAI's consolidated statements of income for the year ended December 31, 2016 and 2015, respectively.

RJR Tobacco now estimates that the maximum remaining amount of its claim and Lorillard Tobacco's claim with respect to the 2003 NPM Adjustment claim is $6 million and $1 million, respectively, plus any applicable interest and earnings. Until such time RJR Tobacco's appeal of the New Mexico state court's ruling that modified the judgment reduction method adopted by the Arbitration Panel has been resolved, including any necessary appeals, uncertainty exists as to the timing, process and amount of RJR Tobacco's ultimate recovery with respect to its remaining share of the 2003 NPM Adjustment claim and, accordingly, no additional amounts have been recognized in RAI's condensed consolidated financial statements (unaudited) as of June 30, 2017.

NPM Adjustment Claims for 2004-2016. From 2006 to 2008, proceedings (including significant factor arbitrations before an independent economic consulting firm) were initiated with respect to the NPM Adjustment for 2004, 2005 and 2006. Ultimately, the Adjustment Requirements were satisfied with respect to each of these NPM Adjustments.

In subsequent years, RJR Tobacco, Lorillard Tobacco, certain other PMs and the settling states entered into three separate agreements, covering fiscal years 2007 to 2009, fiscal years 2010 to 2012, fiscal years 2013 to 2014, and fiscal years 2015 to 2017 respectively, wherein the settling states would not contest that the disadvantages of the MSA were "a significant factor contributing to" the market share loss experienced by the PMs in those years. The stipulation pertaining to each of the years covered by the four agreements became effective in February of the year a final determination by the firm of independent economic consultants would otherwise have been expected if the issue had been arbitrated on the merits. For fiscal years 2015 to 2017, RJR Tobacco and PM USA paid certain amounts to certain of the settling states for each year covered by these agreements, with RJR Tobacco paying approximately 67% of such amounts.

Based on the payment calculations of the Independent Auditor and the agreements described above regarding the significant factor determinations, the Adjustment Requirements have been satisfied with respect to the NPM Adjustments for fiscal years 2007 to 2014. The approximate maximum principal amounts of RJR Tobacco's and Lorillard Tobacco's shares of the disputed NPM Adjustments for the years 2004 through 2014 (in millions), as currently calculated by the Independent Auditor, and the remaining amounts after the settlements of certain NPM Adjustments claims (see below), are as follows (1):

	RJR Tobacco		Lorillard Tobacco	
Volume Year	Disputed	Remaining after settlements	Disputed	Remaining after settlements
2004	$562	$200	$111	$39
2005	445	158	76	27
2006	419	149	73	26
2007	435	157	83	30
2008	468	169	104	38
2009	472	171	107	39
2010	470	170	119	44
2011	422	152	88	32
2012	430	156	97	36
2013	457	165	92	34
2014	433	156	93	34

(1) The amounts shown above do not include the interest or earnings thereon to which RJR Tobacco and Lorillard Tobacco believe they would be entitled under the MSA.

In addition to the above, SFNTC's portion of the disputed NPM Adjustments for the years 2004 through 2014 is approximately $67 million and the remaining amount after the settlements is approximately $25 million.

The 2015 volume year NPM Adjustments for RJR Tobacco, Lorillard Tobacco and SFNTC are $482 million, $41 million, and $18 million, respectively.

The 2016 volume year NPM Adjustments for RJR Tobacco and SFNTC are $505 million and $22 million, respectively.

The 2004 NPM Adjustment proceeding is underway before two overlapping panels, with one panel hearing the issues with respect to five states and the other panel hearing the issues as to the remaining states that will be part of the arbitration. A revised case management order governing the arbitration was entered on January 4, 2017. Under the timing established by that case management order, discovery in the arbitration proceedings was completed by the end of the second quarter of 2017. A hearing on common issues took place starting in June 2017. State specific evidentiary hearings will begin in the fourth quarter of 2017 and will likely conclude by the end of the third quarter of 2018. Diligent enforcement rulings from the panels are likely by the end of the fourth quarter of 2018. RJR Tobacco's and Lorillard Tobacco's remaining claim with respect to 2004 is approximately $239 million collectively.

Missouri obtained an order from the Missouri court of appeals for a separate state specific arbitration of the diligent enforcement issue, but on appeal, the Missouri Supreme Court ordered Missouri to participate in the nationwide arbitration of the 2004 NPM Adjustment. Also, in the context of the 2003 NPM Adjustment proceedings, Montana obtained a ruling from the Montana Supreme Court that the issue of diligent enforcement under the MSA must be heard before that state's MSA court. Finally, New Mexico and the four U.S. territories have been asked to join the 2004 NPM Adjustment Arbitration, but have not yet done so. New Mexico has, however, been ordered by its state court to participate in the nationwide arbitration, although it is appealing that order.

Due to the uncertainty over the final resolution of the 2004-2016 NPM Adjustment claims asserted by RJR Tobacco (including Lorillard Tobacco claims) and SFNTC, no assurances can be made related to the amounts, if any, that will be realized or any amounts (including interest) that will be owed, except as described below related to the partial settlement of certain NPM Adjustment claims.

Settlement/Partial Settlement of Certain NPM Adjustment Claims. In November 2012, RJR Tobacco, certain other PMs and certain settling states entered into a Term Sheet that set forth terms on which accrued and potential NPM Adjustment claims for 2003 through 2014 could be resolved. The Term Sheet also set forth a restructured NPM Adjustment process to be applied on a going-forward basis, starting with the 2013 volume year. The Term Sheet was provided to all of the MSA settling states for their review and consideration. A total of

17 states, the District of Columbia and Puerto Rico, collectively representing approximately 42% allocable share, joined the proposed settlement. RJR Tobacco and the other PMs indicated that they were prepared to go forward with the proposed settlement with that level of jurisdictional participation.

The Term Sheet provided that the Arbitration Panel in place to deal with the 2003 NPM Adjustment (and other NPM Adjustment-related matters) must review the proposed settlement and enter an appropriate order to confirm for the Independent Auditor that it should implement, as necessary, the terms of the settlement agreement.

In March 2013, the Arbitration Panel entered a Stipulated Partial Settlement and Award, referred to as the Award, reflecting the financial terms of the Term Sheet. Shortly thereafter, the Independent Auditor issued a notice indicating that it intended to implement the financial provisions of the Term Sheet, and also issued various revised payment calculations pertaining to payment years 2009 through 2012 and final calculations pertaining to payment year 2013 that reflected implementation of the financial provisions of the Term Sheet.

Subsequently in 2013, Oklahoma, Connecticut and South Carolina joined the Term Sheet. Efforts by two states, Colorado and Ohio, to obtain injunctions to prevent implementation of the Award were unsuccessful that year.

In June 2014, Kentucky and Indiana, both of which were among the states found "non-diligent" by the Arbitration Panel, joined the Term Sheet on financial terms more favorable to the industry than those agreed to by the original signatory states. In April 2017, Rhode Island and Oregon joined the Term Sheet settlement. Twenty-six jurisdictions have now joined the Term Sheet settlement representing approximately 51.73% allocable share.

On October 20, 2015, RJR Tobacco and certain other PMs (including SFNTC) entered into the NY Settlement Agreement with the State of New York to settle certain claims related to the NPM Adjustment. The NY Settlement Agreement resolves NPM Adjustment claims related to payment years from 2004 through 2014 and puts in place a new method to determine future adjustments from 2015 forward as to New York. With the addition of New York's allocable share of 12.76%, RJR Tobacco has resolved the 2004 through 2014 NPM Adjustments with 27 jurisdictions, representing approximately 64.49% allocable share.

For additional information related to the Term Sheet and the NY Settlement Agreement, see "— Cost of Products Sold" in note 1.

Other Litigation and Developments

JTI Claims for Indemnification. By a purchase agreement dated March 9, 1999, amended and restated as of May 11, 1999, referred to as the 1999 Purchase Agreement, RJR and RJR Tobacco sold its international tobacco business to JTI. Under the 1999 Purchase Agreement, RJR and RJR Tobacco retained certain liabilities relating to the international tobacco business sold to JTI. Under its reading of the indemnification provisions of the 1999 Purchase Agreement, JTI has requested indemnification for damages allegedly arising out of these retained liabilities. As previously reported, a number of the indemnification claims between the parties relating to the activities of Northern Brands in Canada have been resolved. The other matters for which JTI has requested indemnification for damages under the indemnification provisions of the 1999 Purchase Agreement are described below:

- In a letter dated March 31, 2006, counsel for JTI stated that JTI would be seeking indemnification under the 1999 Purchase Agreement for any damages it may incur or may have incurred arising out of a Southern District of New York grand jury investigation, a now-terminated Eastern District of North Carolina grand jury investigation, and various actions filed by the European Community and others in the U.S. District Court for the Eastern District of New York, referred to as the EDNY, against RJR Tobacco and certain of its affiliates on November 3, 2000, August 6, 2001, and (as discussed in greater detail below) October 30, 2002, and against JTI on January 11, 2002.
- JTI also has sought indemnification relating to a Statement of Claim filed on April 23, 2010, in the Ontario Superior Court of Justice, London, against JTI Macdonald Corp., referred to as JTI-MC, by the Ontario Flue-Cured Tobacco Growers' Marketing Board, referred to as the Board, Andy J. Jacko, Brian Baswick, Ron Kichler, and Aprad Dobrenty, proceeding on their own behalf and on behalf of a putative class of Ontario tobacco producers that sold tobacco to JTI-MC during the period between January 1, 1986 and December 31, 1996, referred to as the Class Period, through the Board pursuant to certain agreements. The Statement of Claim seeks recovery for damages allegedly incurred by the class

representatives and the putative class for tobacco sales during the Class Period made at the contract price for duty free or export cigarettes with respect to cigarettes that, rather than being sold duty free or for export, purportedly were sold in Canada, which allegedly breached one or more of a series of contracts dated between June 4, 1986, and July 3, 1996. Appeals taken from an unsuccessful motion to dismiss the action as barred by the statute of limitations were ultimately denied on November 4, 2016. Certification proceedings are pending.

- Finally, JTI has advised RJR and RJR Tobacco of its view that, under the terms of the 1999 Purchase Agreement, RJR and RJR Tobacco are liable for approximately $1.85 million related to a judgment entered in 1998, plus interest and costs, in an action filed in Brazil by Lutz Hanneman, a former employee of a former RJR Tobacco subsidiary. RJR and RJR Tobacco deny that they are liable for this judgment under the terms of the 1999 Purchase Agreement.

Although RJR and RJR Tobacco recognize that, under certain circumstances, they may have these and other unresolved indemnification obligations to JTI under the 1999 Purchase Agreement, RJR and RJR Tobacco disagree with JTI as to (1) what circumstances relating to any such matters may give rise to indemnification obligations by RJR and RJR Tobacco, and (2) the nature and extent of any such obligation. RJR and RJR Tobacco have conveyed their position to JTI, and the parties have agreed to resolve their differences at a later time.

European Community. In *European Community v. RJR Nabisco, Inc.* (U.S.D.C. E.D.N.Y., filed 2002), the European Community and several of its member states allege that RJR, RJR Tobacco and other currently and formerly related companies engaged in money laundering and other conduct violating civil RICO and a variety of common laws. The plaintiffs also allege that the defendants manufactured cigarettes that were eventually sold in Iraq in violation of U.S. sanctions. The plaintiffs seek compensatory, punitive and treble damages among other types of relief. On February 15, 2010, the defendants moved to dismiss, and the action has been stayed and largely inactive since then while the parties have litigated that motion. On March 8, 2011, the district court granted the defendants' motion in part and dismissed the plaintiffs' RICO claims. On May 13, 2011, the district court granted the remaining portion of the defendants' motion and dismissed the plaintiffs'state-law claims based on the court's lack of subject matter jurisdiction. The plaintiffs appealed to the Second Circuit.

On April 29, 2014, the Second Circuit vacated and remanded in a decision concluding that (1) as pled, the RICO claims are within the scope of the RICO statute, and (2) the federal court has subject matter jurisdiction over the state-law claims. The defendants sought rehearing and rehearing *en banc*. On August 20, 2014, the Second Circuit denied panel rehearing and issued an amended opinion that, in addition to adhering to the earlier opinion, held that a civil RICO cause of action extends to extraterritorial injuries. The U.S. Supreme Court granted certiorari and, on June 20, 2016, reversed the Second Circuit's decision and ordered the dismissal of the plaintiffs' RICO damages claims, finding that RICO civil causes of action extend only to domestic injuries, which claims the plaintiffs had abandoned. The court also held that any private RICO claims for equitable relief must also rest on domestic injuries but reserved decision on whether the plaintiffs had alleged such claims. The court's decision does not affect the plaintiffs' common-law claims. After remand, the district court entered an order allowing the plaintiffs to file an amended complaint by October 24, 2016, which later was extended indefinitely. Once the amended complaint is filed, the parties have been directed to submit a joint briefing schedule for the defendants' anticipated motion to dismiss. Further, the district court stayed discovery until ten days after entry of an order deciding the defendants' anticipated motion to dismiss.

Fontem Patent Litigation. On April 4, 2016, a case was filed in federal court, *Fontem Ventures B.V. and Fontem Holdings 1 B.V. v. R. J. Reynolds Vapor Company* (U.S.D.C. C.D. Cal.), which alleges that VUSE products infringe four patents owned by Fontem purportedly directed to e-cigarettes. On May 3, 2016, Fontem filed a second complaint asserting that the VUSE products infringe two additional Fontem patents purportedly directed to e-cigarettes. On June 22, 2016, Fontem filed a third complaint asserting that the VUSE products infringe one additional Fontem patent purportedly directed to e-cigarettes. RJR Vapor filed an answer in the first case on June 27, 2016, and an amended answer on July 25, 2016. RJR Vapor also filed answers in the second and third cases on July 25, 2016. On June 29, 2016, RJR Vapor filed a motion to transfer the three cases to the Middle District of North Carolina, which was granted on August 8, 2016. On December 14, 2016, the transferred cases were consolidated with lead case *Fontem Ventures B.V. and Fontem Holdings 1 B.V. v. R. J. Reynolds Vapor Company*, 16-cv-1255 (M.D.N.C.) On March 1, 2017, Fontem filed a fourth complaint in the Middle District of North Carolina asserting that the VUSE products infringe eight additional Fontem patents. RJR Vapor filed an answer to the fourth complaint on April 24, 2017. On April 14, 2017, Fontem filed a motion to amend the consolidated three prior actions to add certain Reynolds entities as additional defendants, which was denied

as moot on May 30, 2017, due to an agreed stipulation where the additional Reynolds entities agreed to be bound by any judgment and to provide discovery as if they were named parties. On May 9, 2017, the fourth action was also consolidated with the lead case.

Also, to date, RJR Vapor has filed multiple petitions for *inter partes* review against seven of the 15 asserted patents. Three of the petitions have been granted, five denied, and the others are still pending decision.

Oklahoma Tax Litigation. On June 7, 2017, Philip Morris USA Inc. and R. J. Reynolds Tobacco Company, among others, filed suit in the Oklahoma Supreme Court alleging that the Oklahoma legislature improperly enacted legislation that would increase the price of cigarettes by $1.50 per pack because the legislature failed to abide by the State's procedures for passing a tax measure. The Oklahoma Supreme Court will hear oral argument on August 8, 2017.

Smokeless Tobacco Litigation

In 1999, when the IPIC litigation was first filed, the named defendants included manufacturers of smokeless products, including Conwood Company, LLC (now known as American Snuff Company, LLC) and others. When the IPIC plaintiffs filed discovery responses in IPIC listing the products they used, 41 of them listed a smokeless product. Six of those 41 plaintiffs listed a brand owned by American Snuff (Levi Garrett). Seven listed a brand (Beechnut) once manufactured by Lorillard Tobacco (now manufactured by National Tobacco Company). On December 3, 2001, the IPIC court severed all smokeless claims and all smokeless defendants from IPIC. There was no order staying the case during IPIC. In the ensuing 15 years, the plaintiffs in the severed cases did nothing to pursue the cases. The plaintiffs now seek to activate various smokeless claims, including certain plaintiffs whose cases were dismissed in IPIC after severance of the smokeless claims and whose claims are not counted in the 41 claims described above. After a status conference on July 11, 2016, the court set a schedule for briefing the issue of whether the severed claims should be dismissed because of the prolonged inaction in the case. On January 25, 2017, the trial court denied the defendants' motion to dismiss those claims as abandoned. The plaintiffs are now free to move forward with their claims, and an initial schedule for discovery has been set through 2019.

ERISA Litigation

In May 2002, in *Tatum v. The R.J.R. Pension Investment Committee of the R. J. Reynolds Tobacco Company Capital Investment Plan*, an employee of RJR Tobacco filed a class-action suit in the U.S. District Court for the Middle District of North Carolina, alleging that the defendants, RJR, RJR Tobacco, the RJR Employee Benefits Committee and the RJR Pension Investment Committee, violated the Employee Retirement Income Security Act of 1974, referred to as ERISA. The actions about which the plaintiff complains stem from a decision made in 1999 by RJR Nabisco Holdings Corp., subsequently renamed Nabisco Group Holdings Corp., referred to as NGH, to spin off RJR, thereby separating NGH's tobacco business and food business. As part of the spin-off, the 401(k) plan for the previously related entities had to be divided into two separate plans for the now separate tobacco and food businesses. The plaintiff contends that the defendants breached their fiduciary duties to participants of the RJR 401(k) plan when the defendants removed the stock funds of the companies involved in the food business, NGH and Nabisco Holdings Corp., referred to as Nabisco, as investment options from the RJR 401(k) plan approximately six months after the spin-off. The plaintiff asserts that a November 1999 amendment (the "1999 Amendment") that eliminated the NGH and Nabisco funds from the RJR 401(k) plan on January 31, 2000, contained sufficient discretion for the defendants to have retained the NGH and Nabisco funds after January 31, 2000, and that the failure to exercise such discretion was a breach of fiduciary duty. In his complaint, the plaintiff requests, among other things, that the court require the defendants to pay as damages to the RJR 401(k) plan an amount equal to the subsequent appreciation that was purportedly lost as a result of the liquidation of the NGH and Nabisco funds.

In July 2002, the defendants filed a motion to dismiss, which the court granted in December 2003. In December 2004, the U.S. Court of Appeals for the Fourth Circuit reversed the dismissal of the complaint, holding that the 1999 Amendment did contain sufficient discretion for the defendants to have retained the NGH and Nabisco funds as of February 1, 2000, and remanded the case for further proceedings. The court granted the plaintiff leave to file an amended complaint and denied all pending motions as moot. In April 2007, the defendants moved to dismiss the amended complaint. The court granted the motion in part and denied it in part, dismissing all claims against the RJR Employee Benefits Committee and the RJR Pension Investment Committee. The plaintiff filed a motion for class certification, which the court granted in September 2008.

A non-jury trial was held in January and February 2010. On February 25, 2013, the district court dismissed the case with prejudice, finding that a hypothetical prudent fiduciary could have made the same decision and thus the plan's loss was not caused by the procedural prudence which the court found to have existed. On August 4, 2014, the Fourth Circuit Court of Appeals, referred to as Fourth Circuit, reversed, holding that the district court applied the wrong standard when it held that the defendants did not cause any loss to the plan, determined the test was whether a hypothetical prudent fiduciary would have made the same decision and remanded the case back to the district court to apply the "would have standard." On February 18, 2016, the district court dismissed the case with prejudice, finding that the defendants have shown by a preponderance of the evidence that a fiduciary acting with prudence would have divested the NGH and Nabisco Funds at the time and in the manner that the defendants did. On March 17, 2016, the plaintiff appealed arguing that the district court erred in finding that a hypothetical prudent fiduciary would have divested the NGH and Nabisco Funds at the same time and in the same manner as RJR. On April 28, 2017, the Fourth Circuit affirmed the district court's judgment in favor of RJR. The plaintiff filed a petition for rehearing *en banc* on May 12, 2017, which was denied on May 26, 2017. The plaintiff agreed to forgo filing a petition for writ of certiorari with the U.S. Supreme Court in exchange for RJR withdrawing its motion for costs in the district court. Therefore, the matter has concluded.

Environmental Matters

RAI and its subsidiaries are subject to federal, state and local environmental laws and regulations concerning the discharge, storage, handling and disposal of hazardous or toxic substances. Such laws and regulations provide for significant fines, penalties and liabilities, sometimes without regard to whether the owner or operator of the property or facility knew of, or was responsible for, the release or presence of hazardous or toxic substances. In addition, third parties may make claims against owners or operators of properties for personal injuries and property damage associated with releases of hazardous or toxic substances. In the past, RJR Tobacco has been named a potentially responsible party with third parties under the Comprehensive Environmental Response, Compensation and Liability Act with respect to several superfund sites. RAI and its subsidiaries are not aware of any current environmental matters that are expected to have a material adverse effect on the business, results of operations or financial position of RAI or its subsidiaries.

RAI and its operating subsidiaries believe that climate change is an environmental issue primarily driven by carbon dioxide emissions from the use of energy. RAI's operating subsidiaries are working to reduce carbon dioxide emissions by minimizing the use of energy where cost effective, minimizing waste to landfills and increasing recycling. Climate change is not viewed by RAI's operating subsidiaries as a significant direct economic risk to their businesses, but rather an indirect risk involving the potential for a longer-term general increase in the cost of doing business. Regulatory changes are difficult to predict, but the current regulatory risks to the business of RAI's operating subsidiaries with respect to climate change are relatively low. Financial impacts will be driven more by the cost of natural gas and electricity. Efforts are made to anticipate the effect of increases in fuel costs directly impacting RAI's operating subsidiaries by evaluating natural gas usage and market conditions. Occasionally forward contracts are purchased, limited to a two-year period, for natural gas. In addition, RAI's operating subsidiaries are continually evaluating energy conservation measures and energy efficient equipment to mitigate impacts of increases in energy costs, and adopting or utilizing such measures and equipment where appropriate.

Regulations promulgated by the EPA and other governmental agencies under various statutes have resulted in, and likely will continue to result in, substantial expenditures for pollution control, waste treatment or handling, facility modification and similar activities. RAI and its subsidiaries are engaged in a continuing program to comply with federal, state and local environmental laws and regulations, and dependent upon the probability of occurrence and reasonable estimation of cost, accrue or disclose any material liability. Although it is difficult to reasonably estimate the portion of capital expenditures or other costs attributable to compliance with environmental laws and regulations, RAI does not expect such expenditures or other costs to have a material adverse effect on the business, results of operations, cash flows or financial position of RAI or its subsidiaries.

Shareholder Cases

Lorillard Transaction. RAI, the members of the RAI board of directors and BAT have been named as defendants in a putative class-action lawsuit captioned *Corwin v. British American Tobacco PLC*, brought in North Carolina state court, referred to as *Corwin*, by a person identifying himself as a shareholder of RAI. *Corwin* was initiated on August 8, 2014, and an amended complaint was filed on November 7, 2014. The amended complaint generally alleges, among other things, that the members of the RAI board of directors breached their fiduciary duties to RAI shareholders by approving the share purchase by BAT and the sharing of

technology with BAT, as well as that there were various conflicts of interest in the transaction. More specifically, the amended complaint alleges that (1) RAI aided and abetted the alleged breaches of fiduciary duties by its board of directors and (2) BAT was a controlling shareholder of RAI and, as a consequence, owed other RAI shareholders fiduciary duties in connection with the BAT Share Purchase. *Corwin* seeks injunctive relief, damages and reimbursement of costs, among other remedies. On January 2, 2015, the plaintiff in *Corwin* filed a motion for a preliminary injunction seeking to enjoin temporarily the RAI shareholder meeting and votes scheduled for January 28, 2015. RAI and the RAI board of directors timely opposed that motion prior to a hearing that was scheduled to occur on January 16, 2015.

RAI believed that *Corwin* was without merit and that no further disclosure was necessary to supplement the Joint Proxy Statement/Prospectus under applicable laws. However, to eliminate certain burdens, expenses and uncertainties, on January 17, 2015, RAI and the director defendants in *Corwin* entered into the North Carolina Memorandum of Understanding regarding the settlement of the disclosure claims asserted in that lawsuit. The North Carolina Memorandum of Understanding outlines the terms of the parties' agreement in principle to settle and release the disclosure claims which were or could have been asserted in *Corwin*. In consideration of the partial settlement and release, RAI agreed to make certain supplemental disclosures to the Joint Proxy Statement/Prospectus, which it did on January 20, 2015. On August 4, 2015, the trial court granted the defendants' motions to dismiss all of the remaining non-disclosure claims. The plaintiff appealed. On February 17, 2016, the trial court approved the partial settlement, including the plaintiff's unopposed request for $415,000 in attorneys' fees and costs. The partial settlement did not affect the consideration paid to Lorillard shareholders in connection with the Lorillard Merger. On December 20, 2016, the North Carolina Court of Appeals affirmed the trial court's dismissal of the claims against RAI and RAI's Board of Directors on the grounds that the plaintiff could not state a direct claim against RAI's Board of Directors for breach of fiduciary duties. The Court of Appeals reversed the dismissal of the claims against BAT. On January 4, 2017, BAT filed a motion for rehearing *en banc* of the Court of Appeals' opinion, which was denied on February 2, 2017. BAT petitioned the North Carolina Supreme Court for review of the Court of Appeals' decision, which was accepted on June 9, 2017.

BAT Transaction. In connection with the Merger Agreement, two putative class action lawsuits were filed in the U.S. District Court for the Middle District of North Carolina against RAI and the members of the RAI board of directors, which are captioned *Drew v. Reynolds American Inc., et al.* (filed June 16, 2017), and *Sneed v. Reynolds American Inc., et al.* (filed June 26, 2017), referred to as the Merger Litigation. The complaints, which were filed by alleged RAI shareholders, generally allege that the definitive proxy statement that RAI filed with the SEC on June 14, 2017, referred to as the RAI Proxy Statement, omitted certain material information in connection with the BAT Merger in violation of Sections 14(a) and 20(a) of the Exchange Act. The complaints seek injunctive relief to prevent the consummation of the BAT Merger unless the allegedly material information is disclosed, damages and attorneys' fees and costs.

RAI believes that the claims asserted in these cases are without merit and that no supplemental disclosure was required under applicable law. Nevertheless, in order to avoid the risk of the Merger Litigation delaying or otherwise adversely affecting the BAT Merger and to minimize the costs, risks and uncertainties inherent in litigation, and without admitting any liability or wrongdoing, on July 11, 2017, RAI filed supplemental disclosures to the RAI Proxy Statement with certain additional information relating to the BAT Merger.

Other Contingencies

JTI Indemnities. In connection with the sale of the international tobacco business to JTI, pursuant to the 1999 Purchase Agreement, RJR and RJR Tobacco agreed to indemnify JTI against:

- any liabilities, costs and expenses arising out of the imposition or assessment of any tax with respect to the international tobacco business arising prior to the sale, other than as reflected on the closing balance sheet;
- any liabilities, costs and expenses that JTI or any of its affiliates, including the acquired entities, may incur after the sale with respect to any of RJR's or RJR Tobacco's employee benefit and welfare plans; and
- any liabilities, costs and expenses incurred by JTI or any of its affiliates arising out of certain activities of Northern Brands.

As described above in "— Litigation Affecting the Cigarette Industry — Other Litigation and Developments — JTI Claims for Indemnification," RJR Tobacco has received claims for indemnification from JTI, and several

of these have been resolved. Although RJR and RJR Tobacco recognize that, under certain circumstances, they may have other unresolved indemnification obligations to JTI under the 1999 Purchase Agreement, RJR and RJR Tobacco disagree what circumstances described in such claims give rise to any indemnification obligations by RJR and RJR Tobacco and the nature and extent of any such obligation. RJR and RJR Tobacco have conveyed their position to JTI, and the parties have agreed to resolve their differences at a later date.

In connection with the sale of the international rights to the NATURAL AMERICAN SPIRIT brand name and associated trademarks to JTI Holding, along with the international companies that distribute and market the brand outside the United States, pursuant to the 2015 Purchase Agreement, SFNTC, R. J. Reynolds Global Products, Inc., and R. J. Reynolds Tobacco B.V. agreed to indemnify JTI Holding against, among other things, any liabilities, costs, and expenses relating to actions:

- commenced on or before (1) January 13, 2019, to the extent relating to alleged personal injuries, and (2) in all other cases, January 13, 2021;
- brought by (1) a governmental authority to enforce legislation implementing European Union Directive 2001/37/EC or European Directive 2014/40/EU or (2) consumers or a consumer association; and
- arising out of any statement or claim (1) made on or before January 13, 2016, (2) by any company sold to JTI Holding in the transaction, (3) concerning NATURAL AMERICAN SPIRIT brand products consumed or intended to be consumed outside of the United States and (4) that the NATURAL AMERICAN SPIRIT brand product is natural, organic, or additive free.

ITG Indemnity. In the purchase agreement relating to the Divestiture, RAI agreed to defend and indemnify, subject to certain conditions and limitations, ITG in connection with claims relating to the purchase or use of one or more of the WINSTON, KOOL, SALEM, or MAVERICK cigarette brands on or before June 12, 2015, as well as in actions filed before June 13, 2023, relating to the purchase or use of one or more of the WINSTON, KOOL, SALEM, or MAVERICK cigarette brands. In the purchase agreement relating to the Divestiture, ITG agreed to defend and indemnify, subject to certain conditions and limitations, RAI and its affiliates in connection with claims relating to the purchase or use of blu brand e-cigarettes. ITG also agreed to defend and indemnify, subject to certain conditions and limitations, RAI and its affiliates in actions filed after June 12, 2023, relating to the purchase or use of one or more of the WINSTON, KOOL, SALEM, or MAVERICK cigarette brands after June 12, 2015.

Loews Indemnity. In 2008, Loews Corporation, referred to as Loews, entered into an agreement with Lorillard, Lorillard Tobacco, and certain of their affiliates, which agreement is referred to as the Separation Agreement. In the Separation Agreement, Lorillard agreed to indemnify Loews and its officers, directors, employees and agents against all costs and expenses arising out of third party claims (including, without limitation, attorneys' fees, interest, penalties and costs of investigation or preparation of defense), judgments, fines, losses, claims, damages, liabilities, taxes, demands, assessments, and amounts paid in settlement based on, arising out of or resulting from, among other things, Loews's ownership of or the operation of Lorillard and its assets and properties, and its operation or conduct of its businesses at any time prior to or following the separation of Lorillard and Loews (including with respect to any product liability claims). Loews is a defendant in three pending product liability actions, each of which is a putative class action. Pursuant to the Separation Agreement, Lorillard is required to indemnify Loews for the amount of any losses and any legal or other fees with respect to such cases. Following the closing of the Lorillard Merger, RJR Tobacco assumed Lorillard's obligations under the Separation Agreement as was required under the Separation Agreement.

Indemnification of Distributors and Retailers. RJR Tobacco, Lorillard Tobacco, SFNTC, American Snuff Co. and RJR Vapor have entered into agreements to indemnify certain distributors and retailers from liability and related defense costs arising out of the sale or distribution of their products. Additionally, SFNTC has entered into an agreement to indemnify a supplier from liability and related defense costs arising out of the sale or use of SFNTC's products. The cost has been, and is expected to be, insignificant. RJR Tobacco, SFNTC, American Snuff Co. and RJR Vapor believe that the indemnified claims are substantially similar in nature and extent to the claims that they are already exposed to by virtue of their having manufactured those products.

Except as otherwise noted above, RAI is not able to estimate the maximum potential amount of future payments, if any, related to these indemnification obligations.

Note 8 — Shareholders' Equity

	Common Stock	Paid- In Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Total Shareholders' Equity
Balance as of December 31, 2016	$—	$18,285	$ 3,740	$(314)	$21,711
Net income	—	—	1,699	—	1,699
Retirement benefits, net of $5 million tax expense	—	—	—	9	9
Cumulative translation adjustment and other, net of $6 million tax expense	—	—	—	14	14
Dividends — $1.02 per share	—	—	(1,459)	—	(1,459)
Common stock repurchased	—	(139)	—	—	(139)
Equity incentive award plan and stock-based compensation	—	51	—	—	51
Balance as of June 30, 2017	$—	$18,197	$ 3,980	$(291)	$21,886

	Common Stock	Paid- In Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Total Shareholders' Equity
Balance as of December 31, 2015	$—	$18,402	$ 188	$(338)	$18,252
Net income	—	—	4,361	—	4,361
Retirement benefits, net of $21 million tax expense	—	—	—	33	33
Long-term investments, net of $3 million tax expense	—	—	—	3	3
Hedging instruments, net of $6 million tax expense	—	—	—	11	11
Cumulative translation adjustment and other, net of $9 million tax expense	—	—	—	17	17
Dividends — $0.84 per share	—	—	(1,204)	—	(1,204)
Common stock repurchased	—	(149)	—	—	(149)
Equity incentive award plan and stock-based compensation	—	50	—	—	50
Excess tax benefit on stock-based compensation plans	—	26	—	—	26
Balance as of June 30, 2016	$—	$18,329	$ 3,345	$(274)	$21,400

Accumulated Other Comprehensive Loss

The components of accumulated other comprehensive loss, net of tax, for the six months ended June 30, 2017 were as follows:

	Retirement Benefits	Cumulative Translation Adjustment and Other	Total
Balance as of December 31, 2016	$(255)	$(59)	$(314)
Other comprehensive income before reclassifications	20	14	34
Amounts reclassified from accumulated other comprehensive loss	(11)	—	(11)
Net current-period other comprehensive income	9	14	23
Balance as of June 30, 2017	$(246)	$(45)	$(291)

The components of accumulated other comprehensive loss, net of tax, for the six months ended June 30, 2016, were as follows:

	Retirement Benefits	Long-Term Investments	Hedging Instruments	Cumulative Translation Adjustment and Other	Total
Balance as of December 31, 2015	$(244)	$(14)	$(11)	$(69)	$(338)
Other comprehensive income (losses) before reclassifications	45	5	—	(10)	40
Amounts reclassified from accumulated other comprehensive loss	(12)	(2)	11	27	24
Net current-period other comprehensive income	33	3	11	17	64
Balance as of June 30, 2016	$(211)	$(11)	$ —	$(52)	$(274)

Details about the reclassifications out of accumulated other comprehensive loss and the affected line items in the condensed consolidated statement of income (unaudited) for the three months ended June 30, were as follows:

Components	Amounts Reclassified		Affected Line Item
	2017	2016	
Retirement benefits:			
Amortization of prior service credit	$(5)	$ (5)	Cost of products sold Selling, general and administrative
Amortization of prior service credit	(4)	(5)	expenses
	(9)	(10)	Operating income
Deferred taxes	2	4	Provision for income taxes
Net of tax	(7)	(6)	Net income
Total reclassifications	$(7)	$ (6)	Net income

Details about the reclassifications out of accumulated other comprehensive loss and the affected line items in the condensed consolidated statement of income (unaudited) for the six months ended June 30, were as follows:

Components	Amounts Reclassified		Affected Line Item
	2017	2016	
Defined benefit pension and postretirement plans:			
Amortization of prior service credit	$ (9)	$(10)	Cost of products sold
Amortization of prior service credit	(8)	(10)	Selling, general and administrative expenses
	(17)	(20)	Operating income
Deferred taxes	6	8	Provision for income taxes
Net of tax	(11)	(12)	Net income
Long-term investments:			
Realized gain on long-term investments	—	(3)	Other expense (income), net
Deferred taxes	—	1	Provision for income taxes
Net of tax	—	(2)	Net income
Hedging instruments:			
Forward starting interest rate contracts	—	16	Other expense (income), net
Amortization of realized loss	—	1	Interest and debt expense
	—	17	Income before income taxes
Deferred taxes	—	(6)	Provision for income taxes
Net of tax	—	11	Net income
Cumulative translation adjustment and other:			
Derecognition of cumulative translation adjustment	—	27	Gain on divestiture
Total reclassifications	$(11)	$ 24	Net income

Share Repurchases and Other

Restricted stock units granted in March 2014 and May 2016 under the Amended and Restated 2009 Omnibus Incentive Compensation Plan, referred to as the Omnibus Plan, vested in March 2017 and May 2017, respectively, and were settled with the issuance of 2,434,400 shares of RAI common stock. In addition, during the first six months of 2017, at a cost of $58 million, RAI purchased 940,607 shares of RAI common stock that were forfeited and cancelled with respect to tax liabilities associated with restricted stock units vesting under the Omnibus Plan.

On July 25, 2016, the board of directors of RAI authorized the repurchase, from time to time, on or before December 31, 2018, of up to $2 billion of outstanding shares of RAI common stock in open-market or privately negotiated transactions, referred to as the Share Repurchase Program. The purchases were subject to prevailing market and business conditions. In connection with the Share Repurchase Program, B&W and Louisville Securities Limited, referred to as LSL, wholly owned subsidiaries of BAT, entered into an agreement, referred to as the Share Repurchase Agreement, with RAI, pursuant to which BAT and its subsidiaries agreed to participate in the Share Repurchase Program on a basis approximately proportionate with BAT's and its subsidiaries' ownership of RAI's common stock. During 2016, RAI repurchased 1,565,698 shares of RAI common stock for $75 million in accordance with the Share Repurchase Program. Subject to certain exceptions, the Merger Agreement placed restrictions on RAI's ability to repurchase its common stock. As a result, RAI did not repurchase any shares under the Share Repurchase Program during the first six months of 2017. The Share Repurchase Program terminated effective with the completion of the BAT Merger on July 25, 2017. For additional information related to the BAT Merger and the termination of the Share Repurchase Program, see note 14.

In November 2011, RAI, B&W and BAT entered into Amendment No. 3 to the Governance Agreement, pursuant to which RAI agreed that, so long as the beneficial ownership interest of BAT and its subsidiaries in RAI had not dropped below 25%, if RAI issued shares of its common stock or any other RAI equity security to certain designated persons, including its directors, officers or employees, then RAI would repurchase a number

of shares of outstanding RAI common stock so that the number of outstanding shares of RAI common stock would not increase, and the beneficial ownership interest of BAT and its subsidiaries in RAI would not decrease, by such issuance after taking into account such repurchase. In February 2017, RAI and BAT entered into a letter agreement, pursuant to which BAT waived the requirement that RAI share repurchases required to be made by RAI pursuant to Amendment No. 3 to the Governance Agreement be made within the time period set forth in that amendment, and permitted RAI to make repurchases in a manner that qualified for the affirmative defense and safe harbor provided by Rules 10b5-1 and 10b-18 under the Exchange Act, respectively. Pursuant to the letter agreement, BAT also waived compliance with the general prohibition on repurchases contained in the Merger Agreement to permit RAI to make these repurchases. During the first six months of 2017, RAI repurchased 1,258,907 shares of RAI common stock for $81 million in accordance with the Governance Agreement.

Due to RAI's incorporation in North Carolina, which does not recognize treasury shares, the shares repurchased were cancelled at time of purchase.

On February 8, 2017, and May 4, 2017, RAI's board of directors declared a quarterly cash dividend of $0.51 per common share, payable to shareholders of record as of March 10, 2017 and June 12, 2017, respectively.

Note 9 — Stock Plans

Outstanding grants under the Omnibus Plan have certain change-of-control terms that either permit assumption of the grants by the acquiring entity for the remaining term or provide for pro-rata or full vesting of the awards upon a change of control. Effective with completion of the BAT Merger on July 25, 2017, a change-of-control event occurred resulting in certain outstanding grants vesting or being assumed by BAT. For additional information related to the impact of the BAT Merger on the outstanding grants, see note 14.

Three-Year Grant

In February 2017, the board of directors of RAI approved a grant to key employees of RAI and its subsidiaries, effective March 1, 2017, of 970,310 nonvested restricted stock units under the Omnibus Plan, referred to as the 2017 Grant. The restricted stock units granted in the 2017 Grant were assumed by BAT upon completion of the BAT Merger and generally will vest on March 1, 2020. Upon settlement, each grantee will receive a number of BAT American Depositary Shares, referred to as BAT ADSs, equal to the product of the number of vested units and a percentage up to 150% based on the average RAI annual incentive award plan score over the three-year period ending December 31, 2019.

As an equity-based grant, compensation expense relating to the 2017 grant will take into account the vesting period lapsed and will be calculated based on the per share closing price of RAI common stock on the date of grant, or $61.93. Following the vesting date, each grantee will receive a cash dividend equivalent payment equal to the aggregate amount of dividends per share paid on shares of RAI common stock or with respect to BAT ADSs, as applicable, during the performance period multiplied by the actual number of restricted stock units earned by the grantee.

Note 10 — Segment Information

RAI's reportable operating segments are RJR Tobacco, Santa Fe and American Snuff. The RJR Tobacco segment consists of the primary operations of R. J. Reynolds Tobacco Company. The Santa Fe segment consists of the primary operations of SFNTC. The American Snuff segment consists of the primary operations of American Snuff Co. Included in All Other, among other RAI subsidiaries, are RJR Vapor, Niconovum USA, Inc., Niconovum AB, and until their sale on January 13, 2016, SFRTI and various foreign subsidiaries affiliated with SFRTI. The segments were identified based on how RAI's chief operating decision maker allocates resources and assesses performance. Certain of RAI's operating subsidiaries have entered into intercompany agreements for products or services with other subsidiaries. As a result, certain activities of an operating subsidiary may be included in a different segment of RAI.

RJR Tobacco is RAI's largest reportable operating segment, and is the second largest tobacco company in the United States. Its brands include three of the top four best-selling cigarettes in the United States: NEWPORT, CAMEL and PALL MALL. These brands, and its other brands, including DORAL, MISTY and CAPRI, are manufactured in a variety of styles and marketed in the United States. As part of its total tobacco strategy, RJR Tobacco offers a smokeless tobacco product, CAMEL Snus. Through the second quarter of 2017, RJR Tobacco manages contract manufacturing of cigarettes and tobacco products through arrangements with BAT affiliates.

RJR Tobacco also manages the export of tobacco products to U.S. territories, U.S. duty-free shops and U.S. overseas military bases. In the United States, RJR Tobacco also manages the premium cigarette brands DUNHILL, which RJR Tobacco licenses from BAT and one or more of its subsidiaries, collectively referred to as the BAT Group, and STATE EXPRESS 555, which RJR Tobacco licenses from CTBAT International Co. Ltd., referred to as CTBAT, a joint venture between the BAT Group and China National Tobacco Corporation, referred to as CNTC.

Santa Fe manufactures and markets premium cigarettes and other tobacco products under the NATURAL AMERICAN SPIRIT brand in the United States.

American Snuff is the second largest smokeless tobacco products manufacturer in the United States, and offers adult tobacco consumers a range of differentiated smokeless tobacco products, primarily moist snuff. The moist snuff category is divided into premium, price-value and popular-price brands. American Snuff's primary brands include its largest selling moist snuff brands, GRIZZLY, in the price-value category, and KODIAK, in the premium category.

RJR Vapor is a marketer of digital vapor cigarettes under the VUSE brand name in the United States. Niconovum USA, Inc. and Niconovum AB are marketers of nicotine replacement therapy products in the United States and Sweden, respectively, under the ZONNIC brand name.

SFRTI and various foreign subsidiaries affiliated with SFRTI distributed the NATURAL AMERICAN SPIRIT brand outside of the United States. On January 13, 2016, RAI, through the Sellers, completed the sale of the international rights to the NATURAL AMERICAN SPIRIT brand name and associated trademarks, along with the international companies that distributed and marketed the brand outside the United States to JTI Holding, in an all-cash transaction of approximately $5 billion and recognized a pre-tax gain of approximately $4.9 billion.

Intersegment revenues and items below the operating income line of the condensed consolidated statements of income (unaudited) are not presented by segment, since they are excluded from the measure of segment profitability reviewed by RAI's chief operating decision maker. Additionally, information about total assets by segment is not reviewed by RAI's chief operating decision maker and therefore is not disclosed.

Segment Data:

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2017	2016	2017	2016
Net sales:				
RJR Tobacco	$2,675	$2,646	$5,046	$5,057
Santa Fe	278	247	516	465
American Snuff	261	232	503	448
All Other	104	70	202	142
Consolidated net sales	$3,318	$3,195	$6,267	$6,112
Operating income (loss):				
RJR Tobacco	$1,291	$1,216	$2,374	$2,323
Santa Fe	169	133	313	256
American Snuff	169	138	326	271
All Other	(21)	(43)	(48)	(77)
Gain on divestiture	—	—	—	4,861
Corporate expense	(52)	(29)	(83)	(77)
Consolidated operating income	$1,556	$1,415	$2,882	$7,557
Reconciliation to income before income taxes:				
Consolidated operating income	$1,556	$1,415	$2,882	$7,557
Interest and debt expense	150	152	299	326
Interest income	(3)	(2)	(5)	(5)
Other expense (income), net	11	(1)	15	251
Income before income taxes	$1,398	$1,266	$2,573	$6,985

Note 11 — Related Party Transactions

On July 25, 2017, as a result of the BAT Merger, RAI became an indirect, wholly owned subsidiary of BAT. Prior to the BAT Merger, BAT, through certain indirect wholly owned subsidiaries, beneficially owned approximately 42% of RAI's outstanding common stock. RAI and RAI's operating subsidiaries engage in transactions with affiliates of BAT.

A summary of balances and transactions with such BAT affiliates is as follows:

	June 30, 2017	December 31, 2016
Current Balances:		
Accounts receivable, related party	$ 1	$113
Due to related party	—	7
Deferred revenue, related party	106	66
Long-term Balances:		
Long-term deferred revenue, related party	$ 19	$ 39

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2017	2016	2017	2016
Significant transactions:				
Net sales	$28	$54	$66	$109
Purchases	1	6	2	8

RJR Tobacco sells contract-manufactured cigarettes, tobacco leaf and processed tobacco to BAT affiliates. In December 2012, RJR Tobacco entered into an amendment to its contract manufacturing agreement (relating to the production of cigarettes to be sold in Japan) with a BAT affiliate, which amendment, among other things, required either party to provide three years' notice to the other party to terminate the agreement without cause, with any such notice to be given no earlier than January 1, 2016. In January 2016, RJR Tobacco received written notice from a BAT affiliate terminating that contract manufacturing agreement effective January 5, 2019. In July 2016, RJR Tobacco further amended the contract manufacturing agreement with a BAT affiliate to permit an early transition of the cigarette production covered by the agreement to BAT facilities over several months beginning in the fourth quarter of 2016. RJR Tobacco ended its contract manufacturing production for BAT in the second quarter of 2017. The amendment provided for a BAT affiliate to make payments to RJR Tobacco of $89.6 million, in exchange for RJR Tobacco's commitment to provide contingent manufacturing capacity to a BAT affiliate through December 31, 2018. Of this amount, $38.7 million was recorded as current deferred revenue, and $19.4 million was recorded as long-term deferred revenue in RAI's condensed consolidated balance sheet (unaudited) as of June 30, 2017. The first installment of $7.4 million was received in September 2016. The second installment of $82.2 million was received in March 2017. RJR Tobacco is recognizing the income ratably from the effective date of the amendment to December 31, 2018. Net sales to BAT affiliates, primarily cigarettes, represented approximately 1% and 2% of RAI's total net sales during the three months ended June 30, 2017 and 2016, respectively. Net sales to BAT affiliates represented approximately 1% and 2% of RAI's total net sales during the six months ended June 30, 2017 and 2016, respectively.

RJR Tobacco recorded deferred sales revenue relating to leaf sold to BAT affiliates that had not been delivered as of the end of the respective quarter, given that RJR Tobacco has a legal right to bill the BAT affiliates. Leaf sales revenue to BAT affiliates was recognized when the product was shipped to the customer.

RAI's operating subsidiaries also purchase unprocessed leaf at market prices, and import cigarettes at prices not to exceed manufacturing costs plus 10%, from BAT affiliates.

In connection with the Share Repurchase Program, B&W and LSL, wholly owned subsidiaries of BAT, entered into the Share Repurchase Agreement on July 25, 2016, with RAI, pursuant to which BAT and its subsidiaries agreed to participate in the Share Repurchase Program on a basis approximately proportionate with BAT's and its subsidiaries' ownership of RAI's common stock. Under the Share Repurchase Agreement, RAI repurchased 660,385 shares of RAI common stock for $32 million from BAT and its subsidiaries during 2016. Subject to certain exceptions, the Merger Agreement placed restrictions on RAI's ability to repurchase its common stock. As a result, RAI did not repurchase any shares under the Share Repurchase Program during the first six months of 2017. The Share Repurchase Program terminated effective with the completion of the BAT Merger on July 25, 2017. For additional information related to the BAT Merger and the termination of the Share Repurchase Program, see note 14.

In January 2016, prior to the sale of the international rights to the NATURAL AMERICAN SPIRIT brand to JTI, SFRTI paid $6 million to a BAT affiliate pursuant to a contract manufacturing agreement, whereby the BAT affiliate agreed to contract manufacture certain tobacco products for SFRTI. The $6 million fee paid to amend the contract was recognized within selling, general and administrative expenses in the condensed consolidated statements of income (unaudited).

Note 12 — RAI Guaranteed, Unsecured Notes — Condensed Consolidating Financial Statements

The following condensed consolidating financial statements relate to the guaranties of RAI's $12.7 billion aggregate principal amount of unsecured notes. Certain of RAI's direct, wholly owned subsidiaries and certain of its indirectly owned subsidiaries fully and unconditionally, and jointly and severally, guaranteed these notes. Pursuant to the terms of the indenture governing such notes, (1) such guarantees were released and terminated automatically upon termination of the Credit Agreement at the closing of the BAT Merger, and (2) RJR provided a new guaranty of RAI's notes given RJR's continuing guaranty of RJR Tobacco's outstanding notes. For additional information on the BAT Merger, see note 14. The following condensed consolidating financial statements include: the accounts and activities of RAI, the parent issuer; RJR, RJR Tobacco, American Snuff Co., SFNTC and certain of RAI's other subsidiaries, the Guarantors; other direct and indirect subsidiaries of RAI that are not Guarantors; and elimination adjustments.

Condensed Consolidating Statements of Income
(Dollars in Millions)

	Parent Issuer	Guarantors	Non-Guarantors	Eliminations	Consolidated
For the Three Months Ended June 30, 2017					
Net sales	$ —	$3,261	$ 54	$ (25)	$3,290
Net sales, related party	—	28	—	—	28
Net sales	—	3,289	54	(25)	3,318
Cost of products sold	—	1,252	53	(27)	1,278
Selling, general and administrative expenses	12	445	21	—	478
Amortization expense	—	6	—	—	6
Operating income (loss)	(12)	1,586	(20)	2	1,556
Interest and debt expense	148	13	4	(15)	150
Interest income	(15)	(2)	(1)	15	(3)
Other expense (income), net	1	(11)	9	12	11
Income (loss) before income taxes	(146)	1,586	(32)	(10)	1,398
Provision for (benefit from) income taxes	(50)	533	(4)	—	479
Equity income from subsidiaries	1,015	(8)	—	(1,007)	—
Net income (loss)	$ 919	$1,045	$(28)	$(1,017)	$ 919
For the Three Months Ended June 30, 2016					
Net sales	$ —	$3,122	$ 48	$ (29)	$3,141
Net sales, related party	—	54	—	—	54
Net sales	—	3,176	48	(29)	3,195
Cost of products sold	—	1,254	52	(31)	1,275
Selling, general and administrative expenses	6	457	34	2	499
Amortization expense	—	6	—	—	6
Operating income (loss)	(6)	1,459	(38)	—	1,415
Interest and debt expense	149	22	2	(21)	152
Interest income	(21)	(2)	—	21	(2)
Other expense (income), net	—	(9)	(3)	11	(1)
Income (loss) before income taxes	(134)	1,448	(37)	(11)	1,266
Provision for (benefit from) income taxes	(48)	532	(14)	—	470
Equity income from subsidiaries	882	2	—	(884)	—
Net income (loss)	$ 796	$ 918	$(23)	$ (895)	$ 796

Condensed Consolidating Statements of Income
(Dollars in Millions)

	Parent Issuer	Guarantors	Non-Guarantors	Eliminations	Consolidated
For the Six Months Ended June 30, 2017					
Net sales	$ —	$ 6,164	$102	$ (65)	$ 6,201
Net sales, related party	—	66	—	—	66
Net sales	—	6,230	102	(65)	6,267
Cost of products sold	—	2,446	96	(65)	2,477
Selling, general and administrative expenses	27	819	50	—	896
Amortization expense	—	11	1	—	12
Operating income (loss)	(27)	2,954	(45)	—	2,882
Interest and debt expense	295	31	8	(35)	299
Interest income	(35)	(4)	(1)	35	(5)
Other expense (income), net	2	(21)	12	22	15
Income (loss) before income taxes	(289)	2,948	(64)	(22)	2,573
Provision for (benefit from) income taxes	(125)	1,013	(14)	—	874
Equity income from subsidiaries	1,863	(13)	—	(1,850)	—
Net income (loss)	$1,699	$ 1,922	$ (50)	$(1,872)	$ 1,699
For the Six Months Ended June 30, 2016					
Net sales	$ —	$ 5,961	$ 97	$ (55)	$ 6,003
Net sales, related party	—	109	—	—	109
Net sales	—	6,070	97	(55)	6,112
Cost of products sold	—	2,403	95	(58)	2,440
Selling, general and administrative expenses	22	858	82	2	964
Gain on divestiture	—	(4,843)	(16)	(2)	(4,861)
Amortization expense	—	12	—	—	12
Operating income (loss)	(22)	7,640	(64)	3	7,557
Interest and debt expense	323	45	4	(46)	326
Interest income	(47)	(4)	—	46	(5)
Other expense (income), net	240	(15)	4	22	251
Income (loss) before income taxes	(538)	7,614	(72)	(19)	6,985
Provision for (benefit from) income taxes	(190)	2,840	(26)	—	2,624
Equity income from subsidiaries	4,709	2	—	(4,711)	—
Net income (loss)	$4,361	$ 4,776	$ (46)	$(4,730)	$ 4,361

Condensed Consolidating Statements of Comprehensive Income
(Dollars in Millions)

	Parent Issuer	Guarantors	Non-Guarantors	Eliminations	Consolidated
For the Three Months Ended June 30, 2017					
Net income (loss)	$ 919	$1,045	$(28)	$(1,017)	$ 919
Other comprehensive income (loss), net of tax:					
Retirement benefits	13	29	(15)	(14)	13
Cumulative translation adjustment and other	11	12	16	(28)	11
Comprehensive income (loss)	$ 943	$1,086	$(27)	$(1,059)	$ 943
For the Three Months Ended June 30, 2016					
Net income (loss)	$ 796	$ 918	$(23)	$ (895)	$ 796
Other comprehensive income (loss), net of tax:					
Retirement benefits	39	40	(1)	(39)	39
Long-term investments	4	4	—	(4)	4
Cumulative translation adjustment and other	(5)	(5)	(7)	12	(5)
Comprehensive income (loss)	$ 834	$ 957	$(31)	$ (926)	$ 834
For the Six Months Ended June 30, 2017					
Net income (loss)	$1,699	$1,922	$(50)	$(1,872)	$1,699
Other comprehensive income (loss), net of tax:					
Retirement benefits	9	26	(14)	(12)	9
Cumulative translation adjustment and other	14	15	20	(35)	14
Comprehensive income (loss)	$1,722	$1,963	$(44)	$(1,919)	$1,722
For the Six Months Ended June 30, 2016					
Net income (loss)	$4,361	$4,776	$(46)	$(4,730)	$4,361
Other comprehensive income (loss), net of tax:					
Retirement benefits	33	34	(1)	(33)	33
Long-term investments	3	3	—	(3)	3
Hedging instruments	11	—	—	—	11
Cumulative translation adjustment and other	17	17	26	(43)	17
Comprehensive income (loss)	$4,425	$4,830	$(21)	$(4,809)	$4,425

Details about the reclassifications out of accumulated other comprehensive loss and the affected line items in the condensed consolidating statements of income (unaudited) for the three months ended June 30, 2017, were as follows:

Components	Amounts Reclassified					Affected Line Item
	Parent Issuer	Guarantors	Non-Guarantors	Eliminations	Consolidated	
Defined benefit pension and postretirement plans:						
Amortization of prior service credit	$—	$ (5)	$—	$—	$ (5)	Cost of products sold
Amortization of prior service credit	—	(4)	—	—	(4)	Selling, general and administrative expenses
	—	(9)	—	—	(9)	Operating income (loss)
Deferred taxes	—	2	—	—	2	Provision for (benefit from) income taxes
Net of tax	—	(7)	—	—	(7)	Net income (loss)
Equity income from subsidiaries	(7)	—	—	7	—	Equity income from subsidiaries
Total reclassifications	$ (7)	$ (7)	$—	$ 7	$ (7)	Net income (loss)

Details about the reclassifications out of accumulated other comprehensive loss and the affected line items in the condensed consolidating statements of income (unaudited) for the three months ended June 30, 2016, were as follows:

Components	Amounts Reclassified					Affected Line Item
	Parent Issuer	Guarantors	Non-Guarantors	Eliminations	Consolidated	
Defined benefit pension and postretirement plans:						
Amortization of prior service credit	$—	$ (5)	$—	$—	$ (5)	Cost of products sold
Amortization of prior service credit	—	(5)	—	—	(5)	Selling, general and administrative expenses
	—	(10)	—	—	(10)	Operating income (loss)
Deferred taxes	—	4	—	—	4	Provision for (benefit from) income taxes
Net of tax	—	(6)	—	—	(6)	Net income (loss)
Equity income from subsidiaries	(6)	—	—	6	—	Equity income from subsidiaries
Total reclassifications	$ (6)	$ (6)	$—	$ 6	$ (6)	Net income (loss)

Notes to Condensed Consolidated Financial Statements (Unaudited) (Continued)

Details about the reclassifications out of accumulated other comprehensive loss and the affected line items in the condensed consolidating statements of income (unaudited) for the six months ended June 30, 2017, were as follows:

Components	Amounts Reclassified					Affected Line Item
	Parent Issuer	Guarantors	Non-Guarantors	Eliminations	Consolidated	
Defined benefit pension and postretirement plans:						
Amortization of prior service credit	$ —	$ (9)	$—	$—	$ (9)	Cost of products sold
Amortization of prior service credit	—	(8)	—	—	(8)	Selling, general and administrative expenses
	—	(17)	—	—	(17)	Operating income (loss)
Deferred taxes	—	6	—	—	6	Provision for (benefit from) income taxes
Net of tax	—	(11)	—	—	(11)	Net income (loss)
Equity income from subsidiaries	(11)	—	—	11	—	Equity income from subsidiaries
Total reclassifications	$(11)	$(11)	$—	$11	$(11)	Net income (loss)

Notes to Condensed Consolidated Financial Statements (Unaudited) (Continued)

Details about the reclassifications out of accumulated other comprehensive loss and the affected line items in the condensed consolidating statements of income (unaudited) for the six months ended June 30, 2016, were as follows:

Components	Amounts Reclassified					Affected Line Item
	Parent Issuer	Guarantors	Non-Guarantors	Eliminations	Consolidated	
Defined benefit pension and postretirement plans:						
Amortization of prior service credit	$—	$(10)	$—	$ —	$(10)	Cost of products sold
Amortization of prior service credit	—	(10)	—	—	(10)	Selling, general and administrative expenses
	—	(20)	—	—	(20)	Operating income (loss)
Deferred taxes	—	8	—	—	8	Provision for (benefit from) income taxes
Net of tax	—	(12)	—	—	(12)	Net income (loss)
Long-term investments:						
Realized gain on long-term investments	—	(3)	—	—	(3)	Other expense (income), net
Deferred taxes	—	1	—	—	1	Provision for (benefit from) income taxes
Net of tax	—	(2)	—	—	(2)	Net income (loss)
Hedging instruments:						
Forward starting interest rate contracts	16	—	—	—	16	Other expense (income), net
Amortization of realized loss	1	—	—	—	1	Interest and debt expense
	17	—	—	—	17	Income (loss) before income taxes
Deferred taxes	(6)	—	—	—	(6)	Provision for (benefit from) income taxes
Net of tax	11	—	—	—	11	Net income (loss)
Cumulative translation adjustment and other:						
Derecognition of cumulative translation adjustment	—	—	27	—	27	Gain on divestiture
Equity income from subsidiaries	13	27	—	(40)	—	Equity income from subsidiaries
Total reclassifications	$24	$ 13	$27	$(40)	$ 24	Net income (loss)

Condensed Consolidating Statements of Cash Flows
(Dollars in Millions)

	Parent Issuer	Guarantors	Non-Guarantors	Eliminations	Consolidated
For the Six Months Ended June 30, 2017					
Cash flows from (used in) operating activities	$ 1,714	$ 606	$ (37)	$(1,006)	$ 1,277
Cash flows from (used in) investing activities:					
Capital expenditures	—	(65)	(1)	—	(66)
Return of intercompany investments	145	—	—	(145)	—
Other, net	205	12	—	(216)	1
Net cash flows from (used in) investing activities	350	(53)	(1)	(361)	(65)
Cash flows from (used in) financing activities:					
Dividends paid on common stock	(1,384)	(985)	—	985	(1,384)
Repurchase of common stock	(139)	—	—	—	(139)
Borrowings under revolving credit facility	500	—	—	—	500
Repayments of borrowings under revolving credit facility	(500)	—	—	—	(500)
Dividends paid on preferred stock	(21)	—	—	21	—
Distribution of equity	—	(145)	—	145	—
Other, net	(11)	(250)	45	216	—
Net cash flows from (used in) financing activities	(1,555)	(1,380)	45	1,367	(1,523)
Effect of exchange rate changes on cash and cash equivalents	—	—	18	—	18
Net change in cash and cash equivalents	509	(827)	25	—	(293)
Cash and cash equivalents at beginning of period	726	997	328	—	2,051
Cash and cash equivalents at end of period	$ 1,235	$ 170	$353	$ —	$ 1,758

Condensed Consolidating Statements of Cash Flows
(Dollars in Millions)

	Parent Issuer	Guarantors	Non-Guarantors	Eliminations	Consolidated
For the Six Months Ended June 30, 2016					
Cash flows from (used in) operating activities	$(1,012)	$ 603	$ (23)	$ (293)	$ (725)
Cash flows from (used in) investing activities:					
Capital expenditures	—	(89)	(5)	—	(94)
Proceeds from settlement of investments	—	182	—	—	182
Proceeds from divestiture	5,015	—	—	—	5,015
Return of intercompany investments	412	26	—	(438)	—
Other, net	260	11	—	(271)	—
Net cash flows from (used in) investing activities	5,687	130	(5)	(709)	5,103
Cash flows from (used in) financing activities:					
Dividends paid on common stock	(1,113)	(247)	(25)	272	(1,113)
Repurchase of common stock	(149)	—	—	—	(149)
Early extinguishment of debt	(3,642)	(8)	—	—	(3,650)
Premiums paid for early extinguishment of debt	(206)	(1)	—	—	(207)
Proceeds from termination of interest rate swaps	—	66	—	—	66
Debt financing fees	(7)	—	—	—	(7)
Excess tax benefit on stock-based compensation plans	26	—	—	—	26
Dividends paid on preferred stock	(21)	—	—	21	—
Distribution of equity	—	(412)	(26)	438	—
Other, net	(11)	(260)	—	271	—
Net cash flows used in financing activities	(5,123)	(862)	(51)	1,002	(5,034)
Effect of exchange rate changes on cash and cash equivalents	—	—	7	—	7
Net change in cash and cash equivalents	(448)	(129)	(72)	—	(649)
Cash and cash equivalents at beginning of period	575	1,544	448	—	2,567
Cash and cash equivalents at end of period	$ 127	$1,415	$376	$ —	$ 1,918

Condensed Consolidating Balance Sheets
(Dollars in Millions)

	Parent Issuer	Guarantors	Non-Guarantors	Eliminations	Consolidated
June 30, 2017					
Assets					
Cash and cash equivalents	$ 1,235	$ 170	$ 353	$ —	$ 1,758
Accounts receivable	—	118	5	—	123
Accounts receivable, related party	—	1	—	—	1
Other receivables	60	1,128	88	(1,265)	11
Inventories	—	1,400	50	(2)	1,448
Other current assets	13	287	4	(9)	295
Total current assets	1,308	3,104	500	(1,276)	3,636
Property, plant and equipment, net of accumulated depreciation	2	1,303	33	—	1,338
Trademarks and other intangible assets, net of accumulated amortization	—	29,420	14	(2)	29,432
Goodwill	—	15,976	16	—	15,992
Long-term intercompany notes receivable	1,184	138	—	(1,322)	—
Investment in subsidiaries	34,501	339	—	(34,840)	—
Other assets and deferred charges	70	44	64	(113)	65
Total assets	$37,065	$50,324	$ 627	$(37,553)	$50,463
Liabilities and shareholders' equity					
Accounts payable	$ 2	$ 182	$ 9	$ —	$ 193
Tobacco settlement accruals	—	1,833	—	—	1,833
Due to related party	—	—	—	—	—
Deferred revenue, related party	—	106	—	—	106
Current maturities of long-term debt	1,695	53	—	—	1,748
Dividends payable on common stock	727	—	—	—	727
Other current liabilities	1,378	756	78	(1,277)	935
Total current liabilities	3,802	2,930	87	(1,277)	5,542
Long-term intercompany notes payable	138	650	534	(1,322)	—
Long-term debt (less current maturities)	11,134	256	—	—	11,390
Long-term deferred income taxes, net	—	9,725	—	(111)	9,614
Long-term retirement benefits (less current portion)	58	1,587	123	—	1,768
Long-term deferred revenue, related party	—	19	—	—	19
Other noncurrent liabilities	47	194	3	—	244
Shareholders' equity (deficit)	21,886	34,963	(120)	(34,843)	21,886
Total liabilities and shareholders' equity	$37,065	$50,324	$ 627	$(37,553)	$50,463

Condensed Consolidating Balance Sheets
(Dollars in Millions)

	Parent Issuer	Guarantors	Non-Guarantors	Eliminations	Consolidated
December 31, 2016					
Assets					
Cash and cash equivalents	$ 726	$ 997	$328	$ —	$ 2,051
Accounts receivable	—	62	4	—	66
Accounts receivable, related party	—	113	—	—	113
Other receivables	63	3,572	17	(3,642)	10
Inventories	—	1,604	43	(2)	1,645
Other current assets	112	238	—	3	353
Total current assets	901	6,586	392	(3,641)	4,238
Property, plant and equipment, net of accumulated depreciation	2	1,314	32	—	1,348
Trademarks and other intangible assets, net of accumulated amortization	—	29,432	14	(2)	29,444
Goodwill	—	15,976	16	—	15,992
Long-term intercompany notes receivable	1,390	148	—	(1,538)	—
Investment in subsidiaries	36,865	333	—	(37,198)	—
Other assets and deferred charges	80	52	37	(96)	73
Total assets	$39,238	$53,841	$491	$(42,475)	$51,095
Liabilities and shareholders' equity					
Accounts payable	$ 1	$ 213	$ 7	$ —	$ 221
Tobacco settlement accruals	—	2,498	—	—	2,498
Due to related party	—	7	—	—	7
Deferred revenue, related party	—	66	—	—	66
Current maturities of long-term debt	448	53	—	—	501
Dividends payable on common stock	656	—	—	—	656
Other current liabilities	3,767	871	40	(3,642)	1,036
Total current liabilities	4,872	3,708	47	(3,642)	4,985
Long-term intercompany notes payable	148	900	490	(1,538)	—
Long-term debt (less current maturities)	12,404	260	—	—	12,664
Long-term deferred income taxes, net	—	9,700	—	(93)	9,607
Long-term retirement benefits (less current portion)	59	1,767	43	—	1,869
Long-term deferred revenue, related party	—	39	—	—	39
Other noncurrent liabilities	44	176	—	—	220
Shareholders' equity (deficit)	21,711	37,291	(89)	(37,202)	21,711
Total liabilities and shareholders' equity	$39,238	$53,841	$491	$(42,475)	$51,095

Note 13 — RJR Tobacco Guaranteed, Unsecured Notes — Condensed Consolidating Financial Statements

The following condensed consolidating financial statements relate to the guaranties of RJR Tobacco's $284 million aggregate principal amount of unsecured notes. RAI and RJR have fully and unconditionally, and jointly and severally, guaranteed these notes. For information on the impact from the BAT Merger, see note 14. The following condensed consolidating financial statements include: the accounts and activities of RAI, the Parent Guarantor; RJR Tobacco, the Issuer; RJR, a Guarantor; other direct and indirect subsidiaries of RAI that are not Guarantors; and elimination adjustments.

Condensed Consolidating Statements of Income (Dollars in Millions)

	Parent Guarantor	Issuer	Guarantor	Non-Guarantors	Eliminations	Consolidated
For the Three Months Ended June 30, 2017						
Net sales	$ —	$2,677	$ —	$ 651	$ (38)	$3,290
Net sales, related party	—	28	—	—	—	28
Net sales	—	2,705	—	651	(38)	3,318
Cost of products sold	—	1,069	—	248	(39)	1,278
Selling, general and administrative expenses, net	12	1,507	—	(1,042)	1	478
Amortization expense	—	4	—	2	—	6
Operating income (loss)	(12)	125	—	1,443	—	1,556
Interest and debt expense	148	2	—	17	(17)	150
Interest income	(15)	(2)	(2)	(1)	17	(3)
Other expense (income), net	1	—	(10)	9	11	11
Income (loss) before income taxes	(146)	125	12	1,418	(11)	1,398
Provision for (benefit from) income taxes	(50)	46	—	483	—	479
Equity income from subsidiaries	1,015	735	813	—	(2,563)	—
Net income	$ 919	$ 814	$825	$ 935	$(2,574)	$ 919
For the Three Months Ended June 30, 2016						
Net sales	$ —	$2,626	$ —	$ 557	$ (42)	$3,141
Net sales, related party	—	54	—	—	—	54
Net sales	—	2,680	—	557	(42)	3,195
Cost of products sold	—	1,108	—	210	(43)	1,275
Selling, general and administrative expenses, net	6	714	—	(223)	2	499
Amortization expense	—	5	—	1	—	6
Operating income (loss)	(6)	853	—	569	(1)	1,415
Interest and debt expense	149	3	—	22	(22)	152
Interest income	(21)	(1)	(1)	(1)	22	(2)
Other expense (income), net	—	2	(10)	(4)	11	(1)
Income (loss) before income taxes	(134)	849	11	552	(12)	1,266
Provision for (benefit from) income taxes	(48)	325	—	193	—	470
Equity income from subsidiaries	882	220	746	—	(1,848)	—
Net income	$ 796	$ 744	$757	$ 359	$(1,860)	$ 796

Condensed Consolidating Statements of Income
(Dollars in Millions)

	Parent Guarantor	Issuer	Guarantor	Non-Guarantors	Eliminations	Consolidated
For the Six Months Ended June 30, 2017						
Net sales	$ —	$5,053	$ —	$ 1,238	$ (90)	$ 6,201
Net sales, related party	—	66	—	—	—	66
Net sales	—	5,119	—	1,238	(90)	6,267
Cost of products sold	—	2,094	—	472	(89)	2,477
Selling, general and administrative expenses, net	27	2,826	(1)	(1,957)	1	896
Amortization expense	—	8	—	4	—	12
Operating income (loss)	(27)	191	1	2,719	(2)	2,882
Interest and debt expense	295	4	—	37	(37)	299
Interest income	(35)	(3)	(2)	(2)	37	(5)
Other expense (income), net	2	1	(21)	12	21	15
Income (loss) before income taxes	(289)	189	24	2,672	(23)	2,573
Provision for (benefit from) income taxes	(125)	84	—	915	—	874
Equity income from subsidiaries	1,863	1,378	1,479	—	(4,720)	—
Net income	$1,699	$1,483	$1,503	$ 1,757	$(4,743)	$ 1,699
For the Six Months Ended June 30, 2016						
Net sales	$ —	$5,009	$ —	$ 1,081	$ (87)	$ 6,003
Net sales, related party	—	109	—	—	—	109
Net sales	—	5,118	—	1,081	(87)	6,112
Cost of products sold	—	2,125	—	404	(89)	2,440
Selling, general and administrative expenses, net	22	1,349	—	(409)	2	964
Gain on divestiture	—	—	—	(4,861)	—	(4,861)
Amortization expense	—	9	—	3	—	12
Operating income (loss)	(22)	1,635	—	5,944	—	7,557
Interest and debt expense	323	3	—	48	(48)	326
Interest income	(47)	(3)	(2)	(1)	48	(5)
Other expense (income), net	240	6	(20)	3	22	251
Income (loss) before income taxes	(538)	1,629	22	5,894	(22)	6,985
Provision for (benefit from) income taxes	(190)	652	—	2,162	—	2,624
Equity income from subsidiaries	4,709	404	1,402	—	(6,515)	—
Net income	$4,361	$1,381	$1,424	$ 3,732	$(6,537)	$ 4,361

Condensed Consolidating Statements of Comprehensive Income
(Dollars in Millions)

	Parent Guarantor	Issuer	Guarantor	Non-Guarantors	Eliminations	Consolidated
For the Three Months Ended June 30, 2017						
Net income	$ 919	$ 814	$ 825	$ 935	$(2,574)	$ 919
Other comprehensive income (loss), net of tax:						
Retirement benefits	13	32	31	(18)	(45)	13
Cumulative translation adjustment and other	11	12	12	12	(36)	11
Comprehensive income	$ 943	$ 858	$ 868	$ 929	$(2,655)	$ 943
For the Three Months Ended June 30, 2016						
Net income	$ 796	$ 744	$ 757	$ 359	$(1,860)	$ 796
Other comprehensive income (loss), net of tax:						
Retirement benefits	39	44	42	(3)	(83)	39
Long-term investments	4	4	4	—	(8)	4
Cumulative translation adjustment and other	(5)	(4)	(5)	(5)	14	(5)
Comprehensive income	$ 834	$ 788	$ 798	$ 351	$(1,937)	$ 834
For the Six Months Ended June 30, 2017						
Net income	$1,699	$1,483	$1,503	$1,757	$(4,743)	$1,699
Other comprehensive income (loss), net of tax:						
Retirement benefits	9	29	28	(17)	(40)	9
Cumulative translation adjustment and other	14	14	15	15	(44)	14
Comprehensive income	$1,722	$1,526	$1,546	$1,755	$(4,827)	$1,722
For the Six Months Ended June 30, 2016						
Net income	$4,361	$1,381	$1,424	$3,732	$(6,537)	$4,361
Other comprehensive income (loss), net of tax:						
Retirement benefits	33	38	36	(3)	(71)	33
Long-term investments	3	3	3	—	(6)	3
Hedging instruments	11	—	—	—	—	11
Cumulative translation adjustment and other	17	17	17	17	(51)	17
Comprehensive income	$4,425	$1,439	$1,480	$3,746	$(6,665)	$4,425

Details about the reclassifications out of accumulated other comprehensive loss and the affected line items in the condensed consolidating statements of income (unaudited) for the three months ended June 30, 2017, were as follows:

Components	Amounts Reclassified						Affected Line Item
	Parent Guarantor	Issuer	Guarantor	Non-Guarantors	Eliminations	Consolidated	
Defined benefit pension and postretirement plans:							
Amortization of prior service credit	$—	$ (5)	$—	$—	$—	$ (5)	Cost of products sold
Amortization of prior service credit	—	(4)	—	—	—	(4)	Selling, general and administrative expenses, net
	—	(9)	—	—	—	(9)	Operating income (loss)
Deferred taxes	—	2	—	—	—	2	Provision for (benefit from) income taxes
Net of tax	—	(7)	—	—	—	(7)	Net income
Equity income from subsidiaries	(7)	—	(7)	—	14	—	Equity income from subsidiaries
Total reclassifications	$ (7)	$ (7)	$ (7)	$—	$14	$ (7)	Net income

Details about the reclassifications out of accumulated other comprehensive loss and the affected line items in the condensed consolidating statements of income (unaudited) for the three months ended June 30, 2016, were as follows:

Components	Amounts Reclassified						Affected Line Item
	Parent Guarantor	Issuer	Guarantor	Non-Guarantors	Eliminations	Consolidated	
Defined benefit pension and postretirement plans:							
Amortization of prior service credit	$—	$ (5)	$—	$—	$—	$ (5)	Cost of products sold
Amortization of prior service credit	—	(5)	—	—	—	(5)	Selling, general and administrative expenses, net
	—	(10)	—	—	—	(10)	Operating income (loss)
Deferred taxes	—	4	—	—	—	4	Provision for (benefit from) income taxes
Net of tax	—	(6)	—	—	—	(6)	Net income
Equity income from subsidiaries	(6)	—	(6)	—	12	—	Equity income from subsidiaries
Total reclassifications	$ (6)	$ (6)	$ (6)	$—	$12	$ (6)	Net income

Details about the reclassifications out of accumulated other comprehensive loss and the affected line items in the condensed consolidating statements of income (unaudited) for the six months ended June 30, 2017, were as follows:

Components	Amounts Reclassified						Affected Line Item
	Parent Guarantor	Issuer	Guarantor	Non-Guarantors	Eliminations	Consolidated	
Defined benefit pension and postretirement plans:							
Amortization of prior service credit	$ —	$ (9)	$ —	$—	$—	$ (9)	Cost of products sold
Amortization of prior service credit	—	(8)	—	—	—	(8)	Selling, general and administrative expenses, net
	—	(17)	—	—	—	(17)	Operating income (loss)
Deferred taxes	—	6	—	—	—	6	Provision for (benefit from) income taxes
Net of tax	—	(11)	—	—	—	(11)	Net income
Equity income from subsidiaries	(11)	—	(11)	—	22	—	Equity income from subsidiaries
Total reclassifications	$(11)	$(11)	$(11)	$—	$22	$(11)	Net income

Details about the reclassifications out of accumulated other comprehensive loss and the affected line items in the condensed consolidating statements of income (unaudited) for the six months ended June 30, 2016, were as follows:

Components	Amounts Reclassified						Affected Line Item
	Parent Guarantor	Issuer	Guarantor	Non-Guarantors	Eliminations	Consolidated	
Defined benefit pension and postretirement plans:							
Amortization of prior service credit	$—	$(10)	$—	$—	$ —	$(10)	Cost of products sold
Amortization of prior service credit	—	(10)	—	—	—	(10)	Selling, general and administrative expenses, net
	—	(20)	—	—	—	(20)	Operating income (loss)
Deferred taxes	—	8	—	—	—	8	Provision for (benefit from) income taxes
Net of tax	—	(12)	—	—	—	(12)	Net income
Long-term investments:							
Realized gain on long-term investments	—	(3)	—	—	—	(3)	Other expense (income), net
Deferred taxes	—	1	—	—	—	1	Provision for (benefit from) income taxes
Net of tax	—	(2)	—	—	—	(2)	Net income
Loss on hedging instruments:							
Forward starting interest rate contracts	16					16	Other expense (income), net
Amortization of realized loss	1	—	—	—	—	1	Interest and debt expense
	17	—	—	—	—	17	Income (loss) before income taxes
Deferred taxes	(6)	—	—	—	—	(6)	Provision for (benefit from) income taxes
Net of tax	11	—	—	—	—	11	Net income
Cumulative translation adjustment and other:							
Derecognition of cumulative translation adjustment	—	—	—	27	—	27	Gain on divestiture
Equity income from subsidiaries	13	27	13	—	(53)	—	Equity income from subsidiaries
Total reclassifications	$24	$ 13	$13	$27	$(53)	$ 24	Net income

Condensed Consolidating Statements of Cash Flows
(Dollars in Millions)

	Parent Guarantor	Issuer	Guarantor	Non-Guarantors	Eliminations	Consolidated
For the Six Months Ended June 30, 2017						
Cash flows from operating activities	$ 1,714	$ 510	$ 442	$ 1,045	$(2,434)	$ 1,277
Cash flows from (used in) investing activities:						
Capital expenditures	—	(46)	—	(20)	—	(66)
Return of intercompany investments	145	12	679	—	(836)	—
Other, net	205	—	9	11	(224)	1
Net cash flows from (used in) investing activities	350	(34)	688	(9)	(1,060)	(65)
Cash flows from (used in) financing activities:						
Dividends paid on common stock	(1,384)	(365)	(985)	(1,063)	2,413	(1,384)
Repurchase of common stock	(139)	—	—	—	—	(139)
Borrowings under revolving credit facility	500	—	—	—	—	500
Repayments of borrowings under revolving credit facility	(500)	—	—	—	—	(500)
Dividends paid on preferred stock	(21)	—	—	—	21	—
Distribution of equity	—	(679)	(145)	(12)	836	—
Other, net	(11)	—	—	(213)	224	—
Net cash flows used in financing activities	(1,555)	(1,044)	(1,130)	(1,288)	3,494	(1,523)
Effect of exchange rate changes on cash and cash equivalents	—	—	—	18	—	18
Net change in cash and cash equivalents	509	(568)	—	(234)	—	(293)
Cash and cash equivalents at beginning of period	726	670	1	654	—	2,051
Cash and cash equivalents at end of period	$ 1,235	$ 102	$ 1	$ 420	$ —	$ 1,758

Condensed Consolidating Statements of Cash Flows
(Dollars in Millions)

	Parent Guarantor	Issuer	Guarantor	Non-Guarantors	Eliminations	Consolidated
For the Six Months Ended June 30, 2016						
Cash flows from (used in) operating activities	$(1,012)	$ 120	$ 38	$ 611	$ (482)	$ (725)
Cash flows from (used in) investing activities:						
Capital expenditures	—	(59)	—	(35)	—	(94)
Proceeds from settlement of investments	—	182	—	—	—	182
Proceeds from divestiture	5,015	—	—	—	—	5,015
Return of intercompany investments	412	495	598	—	(1,505)	—
Other, net	260	—	8	11	(279)	—
Net cash flows from (used in) investing activities	5,687	618	606	(24)	(1,784)	5,103
Cash flows from (used in) financing activities:						
Dividends paid on common stock	(1,113)	(9)	(247)	(205)	461	(1,113)
Repurchase of common stock	(149)	—	—	—	—	(149)
Early extinguishment of debt	(3,642)	(8)	—	—	—	(3,650)
Premiums paid for early extinguishment of debt	(206)	(1)	—	—	—	(207)
Proceeds from termination of interest rate swaps	—	66	—	—	—	66
Debt financing fees	(7)	—	—	—	—	(7)
Excess tax benefit on stock-based compensation plans	26	—	—	—	—	26
Dividends paid on preferred stock	(21)	—	—	—	21	—
Distribution of equity	—	(580)	(412)	(513)	1,505	—
Other, net	(11)	—	—	(268)	279	—
Net cash flows used in financing activities	(5,123)	(532)	(659)	(986)	2,266	(5,034)
Effect of exchange rate changes on cash and cash equivalents	—	—	—	7	—	7
Net change in cash and cash equivalents	(448)	206	(15)	(392)	—	(649)
Cash and cash equivalents at beginning of period	575	809	19	1,164	—	2,567
Cash and cash equivalents at end of period	$ 127	$1,015	$ 4	$ 772	$ —	$ 1,918

Condensed Consolidating Balance Sheets
(Dollars in Millions)

	Parent Guarantor	Issuer	Guarantor	Non-Guarantors	Eliminations	Consolidated
June 30, 2017						
Assets						
Cash and cash equivalents	$ 1,235	$ 102	$ 1	$ 420	$ —	$ 1,758
Accounts receivable	—	72	—	51	—	123
Accounts receivable, related party	—	1	—	—	—	1
Other receivables	60	95	17	1,158	(1,319)	11
Inventories	—	748	—	702	(2)	1,448
Other current assets	13	202	—	89	(9)	295
Total current assets	1,308	1,220	18	2,420	(1,330)	3,636
Property, plant and equipment, net of accumulated depreciation	2	845	—	491	—	1,338
Trademarks and other intangible assets, net of accumulated amortization	—	309	—	29,124	(1)	29,432
Goodwill	—	3,454	9,853	2,685	—	15,992
Long-term intercompany notes receivable	1,184	—	65	138	(1,387)	—
Investment in subsidiaries	34,501	18,674	21,098	—	(74,273)	—
Other assets and deferred charges	70	1,141	10	14	(1,170)	65
Total assets	$37,065	$25,643	$31,044	$34,872	$(78,161)	$50,463
Liabilities and shareholders' equity						
Accounts payable	$ 2	$ 165	$ —	$ 26	$ —	$ 193
Tobacco settlement accruals	—	1,729	—	104	—	1,833
Due to related party	—	—	—	—	—	—
Deferred revenue, related party	—	106	—	—	—	106
Current maturities of long-term debt	1,695	53	—	—	—	1,748
Dividends payable on common stock	727	—	—	—	—	727
Other current liabilities	1,378	592	38	257	(1,330)	935
Total current liabilities	3,802	2,645	38	387	(1,330)	5,542
Long-term intercompany notes payable	138	—	—	1,249	(1,387)	—
Long-term debt (less current maturities)	11,134	256	—	—	—	11,390
Long-term deferred income taxes, net	—	—	—	10,781	(1,167)	9,614
Long-term retirement benefits (less current portion)	58	1,467	26	217	—	1,768
Long-term deferred revenue, related party	—	19	—	—	—	19
Other noncurrent liabilities	47	168	—	29	—	244
Shareholders' equity	21,886	21,088	30,980	22,209	(74,277)	21,886
Total liabilities and shareholders' equity	$37,065	$25,643	$31,044	$34,872	$(78,161)	$50,463

Condensed Consolidating Balance Sheets
(Dollars in Millions)

	Parent Guarantor	Issuer	Guarantor	Non-Guarantors	Eliminations	Consolidated
December 31, 2016						
Assets						
Cash and cash equivalents	$ 726	$ 670	$ 1	$ 654	$ —	$ 2,051
Accounts receivable	—	27	—	39	—	66
Accounts receivable, related party	—	113	—	—	—	113
Other receivables	63	5	38	4,828	(4,924)	10
Inventories	—	812	—	835	(2)	1,645
Other current assets	112	195	—	43	3	353
Total current assets	901	1,822	39	6,399	(4,923)	4,238
Property, plant and equipment, net of accumulated depreciation	2	855	—	491	—	1,348
Trademarks and other intangible assets, net of accumulated amortization	—	317	—	29,129	(2)	29,444
Goodwill	—	3,453	9,853	2,686	—	15,992
Long-term intercompany notes receivable	1,390	—	73	148	(1,611)	—
Investment in subsidiaries	36,865	22,954	23,938	—	(83,757)	—
Other assets and deferred charges	80	1,204	11	13	(1,235)	73
Total assets	$39,238	$30,605	$33,914	$38,866	$(91,528)	$51,095
Liabilities and shareholders' equity						
Accounts payable	$ 1	$ 190	$ —	$ 30	$ —	$ 221
Tobacco settlement accruals	—	2,326	—	172	—	2,498
Due to related party	—	7	—	—	—	7
Deferred revenue, related party	—	66	—	—	—	66
Current maturities of long-term debt	448	53	—	—	—	501
Dividends payable on common stock	656	—	—	—	—	656
Other current liabilities	3,767	1,923	2	268	(4,924)	1,036
Total current liabilities	4,872	4,565	2	470	(4,924)	4,985
Long-term intercompany notes payable	148	—	—	1,463	(1,611)	—
Long-term debt (less current maturities)	12,404	260	—	—	—	12,664
Long-term deferred income taxes, net	—	—	—	10,839	(1,232)	9,607
Long-term retirement benefits (less current portion)	59	1,651	28	131	—	1,869
Long-term deferred revenue, related party	—	39	—	—	—	39
Other noncurrent liabilities	44	153	—	23	—	220
Shareholders' equity	21,711	23,937	33,884	25,940	(83,761)	21,711
Total liabilities and shareholders' equity	$39,238	$30,605	$33,914	$38,866	$(91,528)	$51,095

Note 14 — Subsequent Event

On July 25, 2017, BAT acquired the remaining approximately 58% of RAI's outstanding common stock not owned by BAT in a cash and stock transaction, valued at approximately $54.5 billion, pursuant to the Merger Agreement, wherein Merger Sub merged with and into RAI, with RAI surviving as an indirect, wholly owned subsidiary of BAT. At the effective time of the BAT Merger, each share of RAI common stock (other than any shares of RAI common stock owned by BAT or any of its subsidiaries, by RAI or any of its subsidiaries and by shareholders of RAI who properly asserted and did not lose or effectively withdraw appraisal rights) was converted into the right to receive 0.5260 of a BAT ADS, and $29.44 in cash, without interest, collectively referred to as the merger consideration.

BAT is subject to applicable SEC reporting obligations as a foreign private issuer. The BAT ADSs trade on the NYSE, under the symbol BTI.

Immediately upon the closing of the BAT Merger, certain change-of-control provisions contained in equity awards granted to RAI employees under the Omnibus Plan were met, which resulted in the accelerated vesting of

those equity awards. With respect to the equity awards that accelerated in connection with the BAT Merger, such equity awards were converted into the right to receive merger consideration in accordance with the terms of the Omnibus Plan and the applicable equity award agreement. All remaining equity awards that were not eligible for accelerated vesting were assumed and replaced with equity awards issued by BAT.

In addition, certain deferred stock units granted to eligible directors of RAI under the Equity Incentive Award Plan for Directors of Reynolds American Inc., referred to as the EIAP, were settled in cash or merger consideration, as applicable, in accordance with the terms of the EIAP and the elections of each applicable director. Deferred stock units held by eligible directors of RAI under the Deferred Compensation Plan for Directors of Reynolds American Inc., referred to as the DCP, that tracked the value of shares of RAI common stock before the BAT Merger, were converted into deferred stock units tracking the value of BAT ADSs and remain outstanding in accordance with the terms of the DCP.

Also, upon completion of the BAT Merger:

- RAI terminated its Credit Agreement and, in doing so, the related subsidiary guarantees of the Credit Agreement also terminated and were released. The RAI indenture provides that a guarantor that is released from its guarantee of the Credit Agreement (or any successor) also will be released from its guarantee of the RAI notes. Accordingly, in connection with the termination of the Credit Agreement, all of the subsidiary guarantees of the RAI notes were released automatically at the same time. Although RJR's guarantee of the RAI notes also was released automatically, it was replaced simultaneously by a new guarantee in order to comply with a covenant of the RAI indenture. The guarantees by RAI and RJR of the RJR Tobacco notes were not released.
- BAT extended separate guarantees of the outstanding senior notes of RAI and RJR Tobacco.
- The Share Repurchase Program, approved by the board of directors on July 25, 2016, terminated.

After completion of the BAT Merger, RAI notified the NYSE of its intent to remove the RAI common stock from listing on the NYSE and requested that the NYSE file with the SEC an application on Form 25 to report the delisting of the RAI common stock from the NYSE under Section 12(b) of the Exchange Act. On July 25, 2017, the NYSE filed with the SEC a Form 25 to delist and deregister the RAI common stock. As a result, shares of RAI common stock were suspended from trading on the NYSE as of 8:40 AM on July 25, 2017. RAI is in the process of deregistering its common stock with the SEC under Section 12(g) of the Exchange Act and suspending its reporting obligations under Sections 13(a) and 15(d) of the Exchange Act by filing a Form 15 with the SEC promptly after the Form 25 becomes effective. After the filing of this Quarterly Report on Form 10-Q, RAI will no longer file periodic reports under the Exchange Act, with the SEC, with respect to its common stock.

It is further expected that RAI will guarantee all debt securities outstanding, or which may be issued in the future, under BAT's £25 billion Euro Medium Term Note Program issued by a finance subsidiary of BAT and guaranteed by BAT and certain of its other subsidiaries. In addition, RAI is expected to guarantee debt that certain BAT subsidiaries anticipate issuing to refinance a portion of the acquisition facility used to fund the cash portion of the merger consideration.

Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders
Reynolds American Inc.:

We have audited the accompanying consolidated balance sheets of Reynolds American Inc. and subsidiaries as of December 31, 2016 and 2015, and the related consolidated statements of income, comprehensive income, shareholders' equity, and cash flows for each of the years in the three - year period ended December 31, 2016. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Reynolds American Inc. and subsidiaries as of December 31, 2016 and 2015, and the results of their operations and their cash flows for each of the years in the three - year period ended December 31, 2016, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Reynolds American Inc.'s internal control over financial reporting as of December 31, 2016, based on criteria established in *Internal Control — Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated February 9, 2017 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

/s/ KPMG LLP

Greensboro, North Carolina
February 9, 2017

Management's Report on Internal Control over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Rule 13a-15(f) of the Securities Exchange Act of 1934. Internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with generally accepted accounting principles and includes those policies and procedures that:

(i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of RAI,

(ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of RAI are being made only in accordance with authorizations of management and directors of RAI, and

(iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of RAI's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements and even when determined to be effective, can only provide reasonable assurance with respect to financial statement preparation and presentation. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies and procedures may deteriorate.

Management conducted an evaluation of the effectiveness of RAI's internal control over financial reporting based on the framework in *Internal Control — Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this evaluation, management concluded that RAI's system of internal control over financial reporting was effective as of December 31, 2016.

KPMG LLP, independent registered public accounting firm, has audited RAI's consolidated financial statements and issued an attestation report on RAI's internal control over financial reporting as of December 31, 2016.

Dated: February 9, 2017

Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders
Reynolds American Inc.:

We have audited Reynolds American Inc.'s internal control over financial reporting as of December 31, 2016, based on criteria established in *Internal Control — Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Reynolds American Inc.'s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Reynolds American Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2016, based on criteria established in *Internal Control — Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Reynolds American Inc. and subsidiaries as of December 31, 2016 and 2015, and the related consolidated statements of income, comprehensive income, shareholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2016, and our report dated February 9, 2017 expressed an unqualified opinion on those consolidated financial statements.

/s/ KPMG LLP

Greensboro, North Carolina
February 9, 2017

REYNOLDS AMERICAN INC.

CONSOLIDATED STATEMENTS OF INCOME
(Dollars in Millions, Except Per Share Amounts)

	For the Years Ended December 31,		
	2016	**2015**	**2014**
Net sales (1)	$12,277	$10,416	$8,160
Net sales, related party	226	259	311
Net sales	12,503	10,675	8,471
Costs and expenses:			
Cost of products sold (1)	4,841	4,688	4,058
Selling, general and administrative expenses	1,931	2,098	1,871
Gain on divestitures	(4,861)	(3,181)	—
Amortization expense	23	18	11
Asset impairment and exit charges	—	99	—
Operating income	10,569	6,953	2,531
Interest and debt expense	626	570	286
Interest income	(8)	(6)	(3)
Other (income) expense, net	260	5	(14)
Income from continuing operations before income taxes	9,691	6,384	2,262
Provision for income taxes	3,618	3,131	817
Income from continuing operations	6,073	3,253	1,445
Income from discontinued operations, net of tax	—	—	25
Net income	$ 6,073	$ 3,253	$1,470
Basic income per share:			
Income from continuing operations	$ 4.26	$ 2.57	$ 1.36
Income from discontinued operations	—	—	0.02
Net income	$ 4.26	$ 2.57	$ 1.38
Diluted income per share:			
Income from continuing operations	$ 4.25	$ 2.57	$ 1.35
Income from discontinued operations	—	—	0.02
Net income	$ 4.25	$ 2.57	$ 1.37
Dividends declared per share	$ 1.76	$ 1.39	$ 1.34

(1) Excludes excise taxes of $4,343 million, $4,209 million and $3,625 million for the years ended December 31, 2016, 2015 and 2014, respectively.

See Notes to Consolidated Financial Statements

REYNOLDS AMERICAN INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Dollars in Millions)

	For the Years Ended December 31,		
	2016	**2015**	**2014**
Net income	$6,073	$3,253	$1,470
Other comprehensive income (loss), net of tax (benefit) expense:			
Retirement benefits, net of tax (2016 — $(6); 2015 —$32; 2014 — $(178))	(11)	50	(277)
Long-term investments, net of tax (2016 — $10; 2014 —$1)	14	—	2
Hedging instruments, net of tax (2016 — $6; 2015 — $1; 2014 — $1)	11	1	1
Cumulative translation adjustment and other, net of tax (2016 —$6; 2015 —$(12); 2014 — $(15))	10	(25)	(34)
Comprehensive income	$6,097	$3,279	$1,162

See Notes to Consolidated Financial Statements

REYNOLDS AMERICAN INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS
(Dollars in Millions)

	For the Years Ended December 31,		
	2016	**2015**	**2014**
Cash flows from (used in) operating activities:			
Net income	$ 6,073	$ 3,253	$ 1,470
Income from discontinued operations, net of tax	—	—	(25)
Adjustments to reconcile to net cash flows from (used in) operating activities:			
Gain on divestitures	(4,861)	(3,181)	—
Loss on early extinguishment of debt and related expenses	239	—	—
Asset impairment and exit charges, net of cash payments	—	94	
Depreciation and amortization expense	123	122	106
Deferred income tax expense (benefit)	387	(659)	(180)
Other changes that provided (used) cash:			
Accounts and other receivables	24	86	(3)
Inventories	89	31	(154)
Related party, net	(5)	14	—
Accounts payable	42	32	(43)
Accrued liabilities, including other working capital	(160)	(242)	30
Tobacco settlement accruals	(314)	239	92
Pension and postretirement	(415)	91	317
Other, net	58	316	13
Net cash flows from operating activities	1,280	196	1,623
Cash flows from (used in) investing activities:			
Capital expenditures	(206)	(174)	(204)
Proceeds from settlement of investments	266	332	4
Acquisition, net of cash acquired	—	(17,220)	—
Proceeds from divestitures	5,015	7,056	—
Proceeds from termination of joint venture	—	—	35
Other, net	3	1	(40)
Net cash flows from (used in) investing activities	5,078	(10,005)	(205)
Cash flows from (used in) financing activities:			
Dividends paid on common stock	(2,369)	(1,583)	(1,411)
Repurchase of common stock	(226)	(124)	(440)
Repayments of long-term debt	(500)	(450)	—
Early extinguishment of debt	(3,650)	—	—
Premiums paid for early extinguishment of debt	(207)	—	—
Proceeds from termination of interest rate swaps	66	—	—
Proceeds from BAT Share Purchase	—	4,673	—
Issuance of long-term debt	—	8,975	—
Debt issuance costs and financing fees	(8)	(70)	(79)
Borrowings under revolving credit facility	—	1,400	1,000
Repayments of borrowings under revolving credit facility	—	(1,400)	(1,000)
Excess tax benefit on stock-based compensation plans	28	17	12
Net cash flows from (used in) financing activities	(6,866)	11,438	(1,918)
Effect of exchange rate changes on cash and cash equivalents	(8)	(28)	(34)
Net change in cash and cash equivalents	(516)	1,601	(534)
Cash and cash equivalents at beginning of year	2,567	966	1,500
Cash and cash equivalents at end of year	$ 2,051	$ 2,567	$ 966
Income taxes paid, net of refunds	$ 3,179	$ 3,744	$ 974
Interest paid	$ 712	$ 510	$ 252
Fair value of equity consideration issued in the Lorillard Merger	$ —	$ 7,555	$ —

See Notes to Consolidated Financial Statements

REYNOLDS AMERICAN INC.

CONSOLIDATED BALANCE SHEETS
(Dollars in Millions)

	December 31,	
	2016	2015
Assets		
Current assets:		
Cash and cash equivalents	$ 2,051	$ 2,567
Short-term investments	—	149
Accounts receivable	66	68
Accounts receivable, related party	113	38
Other receivables	10	35
Inventories	1,645	1,734
Other current assets	353	564
Total current assets	4,238	5,155
Property, plant and equipment, at cost:		
Land and land improvements	95	94
Buildings and leasehold improvements	757	727
Machinery and equipment	2,064	1,967
Construction-in-process	94	110
Total property, plant and equipment	3,010	2,898
Accumulated depreciation	(1,662)	(1,643)
Property, plant and equipment, net	1,348	1,255
Trademarks and other intangible assets, net of accumulated amortization	29,444	29,467
Goodwill	15,992	15,993
Other assets and deferred charges	73	230
	$51,095	$52,100
Liabilities and shareholders' equity		
Current liabilities:		
Accounts payable	$ 221	$ 179
Tobacco settlement accruals	2,498	2,816
Due to related party	7	9
Deferred revenue, related party	66	33
Current maturities of long-term debt	501	506
Dividends payable on common stock	656	514
Other current liabilities	1,036	1,234
Total current liabilities	4,985	5,291
Long-term debt (less current maturities)	12,664	16,849
Long-term deferred income taxes, net	9,607	9,204
Long-term retirement benefits (less current portion)	1,869	2,265
Long-term deferred revenue, related party	39	—
Other noncurrent liabilities	220	239
Commitments and contingencies:		
Shareholders' equity:		
Common stock (shares issued: 2016 — 1,425,824,955; 2015 —1,427,341,341)	—	—
Paid-in capital	18,285	18,402
Retained earnings	3,740	188
Accumulated other comprehensive loss	(314)	(338)
Total shareholders' equity	21,711	18,252
	$51,095	$52,100

See Notes to Consolidated Financial Statements

REYNOLDS AMERICAN INC.

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
(Dollars in Millions, Except Per Share Amounts)

	Common Stock	Paid-In Capital	Retained Earnings (Accumulated Deficit)	Accumulated Other Comprehensive Loss	Total Shareholders' Equity
Balance at December 31, 2013	$—	$ 6,571	$(1,348)	$ (56)	$ 5,167
Net income	—	—	1,470	—	1,470
Retirement benefits, net of $178 tax benefit	—	—	—	(277)	(277)
Long-term investments, net of $1 tax expense	—	—	—	2	2
Hedging instruments, net of $1 tax expense	—	—	—	1	1
Cumulative translation adjustment and other, net of $15 tax benefit	—	—	—	(34)	(34)
Dividends — $1.34 per share	—	—	(1,436)	—	(1,436)
Common stock repurchased	—	(440)	—	—	(440)
Equity incentive award plan and stock-based compensation	—	57	—	—	57
Excess tax benefit on stock-based compensation plans	—	12	—	—	12
Balance at December 31, 2014	—	6,200	(1,314)	(364)	4,522
Net income	—	—	3,253	—	3,253
Retirement benefits, net of $32 tax expense	—	—	—	50	50
Hedging instruments, net of $1 tax expense	—	—	—	1	1
Cumulative translation adjustment and other, net of $12 tax benefit	—	—	—	(25)	(25)
Dividends — $1.39 per share	—	—	(1,751)	—	(1,751)
Issuance of additional shares as Lorillard Merger Consideration	—	7,555	—	—	7,555
Issuance of additional shares for BAT Share Purchase	—	4,673	—	—	4,673
Common stock repurchased	—	(124)	—	—	(124)
Equity incentive award plan and stock-based compensation	—	81	—	—	81
Excess tax benefit on stock-based compensation plans	—	17	—	—	17
Balance at December 31, 2015	—	18,402	188	(338)	18,252
Net income	—	—	6,073	—	6,073
Retirement benefits, net of $6 tax benefit	—	—	—	(11)	(11)
Long-term investments, net of $10 tax expense	—	—	—	14	14
Hedging instruments, net of $6 tax expense	—	—	—	11	11
Cumulative translation adjustment and other, net of $6 tax expense	—	—	—	10	10
Dividends — $1.76 per share	—	—	(2,521)	—	(2,521)
Common stock repurchased	—	(226)	—	—	(226)
Equity incentive award plan and stock-based compensation	—	81	—	—	81
Excess tax benefit on stock-based compensation plans	—	28	—	—	28
Balance at December 31, 2016	$—	$18,285	$ 3,740	$(314)	$21,711

See Notes to Consolidated Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 — Business and Summary of Significant Accounting Policies

Overview

The consolidated financial statements include the accounts of Reynolds American Inc., referred to as RAI, and its wholly owned subsidiaries. RAI's wholly owned operating subsidiaries include R. J. Reynolds Tobacco Company; Santa Fe Natural Tobacco Company, Inc., referred to as SFNTC; American Snuff Company, LLC, referred to as American Snuff Co.; R. J. Reynolds Vapor Company, referred to as RJR Vapor; Niconovum USA, Inc.; Niconovum AB; and until their sale on January 13, 2016, as described below, SFR Tobacco International GmbH, referred to as SFRTI, and various foreign subsidiaries affiliated with SFRTI.

RAI was incorporated as a holding company in the State of North Carolina on January 2, 2004, and its common stock is listed on the New York Stock Exchange, referred to as the NYSE, under the symbol "RAI." On July 30, 2004, the U.S. assets, liabilities and operations of Brown & Williamson Tobacco Corporation, now known as Brown & Williamson Holdings, Inc., referred to as B&W, an indirect, wholly owned subsidiary of British American Tobacco p.l.c., referred to as BAT, were combined with R. J. Reynolds Tobacco Company, a wholly owned operating subsidiary of R.J. Reynolds Tobacco Holdings, Inc., referred to as RJR. These July 30, 2004, transactions generally are referred to as the B&W business combination.

References to RJR Tobacco prior to July 30, 2004, relate to R. J. Reynolds Tobacco Company, a New Jersey corporation. References to RJR Tobacco on and subsequent to July 30, 2004 and until June 12, 2015, relate to the combined U.S. assets, liabilities and operations of B&W and R. J. Reynolds Tobacco Company. Concurrent with the completion of the B&W business combination, RJR Tobacco became a North Carolina corporation. References to RJR Tobacco on and subsequent to June 12, 2015, relate to R. J. Reynolds Tobacco Company, a North Carolina corporation, and reflect the effects of the Lorillard Merger and Divestiture, described below.

Proposed Merger with BAT

On January 17, 2017, RAI announced that it had entered into an Agreement and Plan of Merger, referred to as the Merger Agreement, with BAT, BATUS Holdings Inc., a Delaware corporation and a wholly owned subsidiary of BAT, and Flight Acquisition Corporation, a North Carolina corporation and a wholly owned subsidiary of BAT, referred to as Merger Sub. For additional information, see note 22 to consolidated financial statements.

Recent Transactions

On June 12, 2015, RAI acquired Lorillard, Inc., n/k/a Lorillard, LLC, referred to as Lorillard, in a cash and stock transaction, valued at $25.8 billion, referred to as the Lorillard Merger. Also on June 12, 2015, a wholly owned subsidiary, n/k/a ITG Brands, LLC, referred to as ITG, of Imperial Brands, PLC, f/k/a Imperial Tobacco Group, PLC, referred to as Imperial, acquired for approximately $7.1 billion, in a transaction referred to as the Divestiture, certain assets (1) owned by RAI subsidiaries or affiliates relating to the cigarette brands WINSTON, KOOL and SALEM, and (2) owned by Lorillard subsidiaries or affiliates related to the cigarette brand MAVERICK and the "e-vapor" brand blu (including SKYCIG), as well as Lorillard's owned and leased real property, and certain transferred employees, together with associated liabilities. As a result of the Divestiture, RAI recognized a pre-tax gain of approximately $3.2 billion. Additionally on June 12, 2015, shortly after the completion of the Lorillard Merger, Lorillard Tobacco Company, LLC, a wholly owned subsidiary of Lorillard, referred to as Lorillard Tobacco, merged with and into RJR Tobacco, with RJR Tobacco continuing as the surviving entity, referred to as the Lorillard Tobacco Merger. The statements of financial position and results of operations contained in the consolidated financial statements reflect the results of the Lorillard Merger and Divestiture and related transactions. For additional information on the Lorillard Merger and Divestiture, and related transactions, see note 2 to consolidated financial statements.

On June 12, 2015, concurrently with the completion of the Lorillard Merger and Divestiture, BAT indirectly (through a wholly-owned subsidiary) purchased 77,680,259 shares of RAI common stock, prior to giving effect to RAI's 2015 two-for-one stock split, referred to as the BAT Share Purchase, for approximately $4.7 billion, which was sufficient for BAT and its subsidiaries collectively to maintain their approximately 42% beneficial ownership of RAI.

On January 13, 2016, RAI, through various subsidiaries, referred to as the Sellers, completed the sale of the international rights to the NATURAL AMERICAN SPIRIT brand name and associated trademarks, along with SFRTI and other international companies that distributed and marketed the brand outside the United States, to JT International Holding BV, referred to as JTI Holding, a subsidiary of Japan Tobacco Inc., referred to as JTI, in an

all-cash transaction of approximately $5 billion and recognized a pre-tax gain of approximately $4.9 billion. The transaction did not include the rights to the NATURAL AMERICAN SPIRIT brand name and associated trademarks in the U.S. market, U.S. duty-free locations and U.S. territories or in U.S. military outlets, all of which were retained by SFNTC. With this transaction completed, the international rights to nearly all of RAI's operating companies' cigarette trademarks are now owned by international tobacco companies. For additional information on the transaction, see note 3.

Operating segments

RAI's reportable operating segments are RJR Tobacco, Santa Fe and American Snuff. The RJR Tobacco segment consists of the primary operations of R. J. Reynolds Tobacco Company. The Santa Fe segment consists of the primary operations of SFNTC. The American Snuff segment consists of the primary operations of American Snuff Co. Included in All Other, among other RAI subsidiaries, are RJR Vapor, Niconovum USA, Inc., Niconovum AB, and until their sale on January 13, 2016, as described above, SFRTI, and various foreign subsidiaries affiliated with SFRTI. The segments were identified based on how RAI's chief operating decision maker allocates resources and assesses performance. Certain of RAI's operating subsidiaries have entered into intercompany agreements for products or services with other subsidiaries. As a result, certain activities of an operating subsidiary may be included in a different segment of RAI.

RAI's operating subsidiaries primarily conduct their business in the United States.

Basis of Presentation

The preparation of the consolidated financial statements in conformity with accounting principles generally accepted in the United States of America, referred to as GAAP, requires estimates and assumptions to be made that affect the reported amounts in the consolidated financial statements and accompanying notes. Volatile credit and equity markets, changes to regulatory and legal environments, and consumer spending may affect the uncertainty inherent in such estimates and assumptions. Actual results could materially differ from those estimates. All material intercompany balances have been eliminated.

Certain reclassifications were made to conform prior years' financial statements to the current presentation. Certain amounts presented in note 13 are rounded in the aggregate and may not sum from the individually presented components. All dollar amounts, other than per share amounts, are presented in millions, except for amounts set forth in note 13 and as otherwise noted.

Business Combination

RAI accounts for business combination transactions in accordance with the Financial Accounting Standards Board, referred to as the FASB, Accounting Standards Codification 805, *Business Combinations*, referred to as ASC 805. RAI allocates the cost of an acquisition to the assets acquired and liabilities assumed based on their fair values as of the acquisition date. Any excess of the purchase price over the estimated fair value of net assets acquired is recorded as goodwill. Determining the fair value of these items requires management's judgment and may require utilization of independent valuation experts to assist with such valuations. These valuations involve the use of significant estimates and assumptions with respect to the timing and amounts of future cash flows, discount rates, market prices, and asset lives, among other items. The judgments made in the determination of the estimated fair value of the assets acquired and the liabilities assumed as well as the estimated useful life of each asset and the duration of each liability can materially impact the financial statements in periods after the acquisition, such as depreciation, amortization, or in certain situations, impairment charges.

The fair value of acquired intangible assets measured on a nonrecurring basis, was determined based on inputs that are unobservable and significant to the overall fair value measurement. As such, acquired intangible assets are classified as Level 3. RAI engaged the services of a third party valuation expert to assist in determining the fair value of acquired trademarks and customer lists. The acquired trademarks and customer lists were valued utilizing the income approach and were based on a discounted cash flow valuation model. This approach utilized unobservable factors, such as royalty rate, projected revenues and a discount rate, applied to the estimated cash flows. The determination of the discount rate was based on a cost of equity model, using a risk-free rate, adjusted by a stock beta-adjusted risk premium and size premium.

The fair value of acquired long-term debt was determined based on significant inputs that are observable either directly or indirectly, and are quoted prices for similar instruments in active markets or quoted prices for identical or similar instruments in markets that are not active. As such, acquired long-term debt is classified as

Level 2. RAI engaged the services of a financial institution in determining the fair value of acquired long-term debt. The acquired long-term debt was valued utilizing market quotes, credit spreads and discounted cash flows, as appropriate. RAI performed its own independent valuation to assess the reasonableness of that calculated by the financial institution.

As a market participant, RAI determined the fair value of inventories and property, plant and equipment utilizing internal resources and external experts. The fair value of finished goods inventories was determined using selling price less estimated costs to dispose. The fair value of other inventories, primarily leaf tobacco acquired, was based on recent costs for similar inventory purchased by RAI and its subsidiaries or historical cost as appropriate. To fair value property, plant and equipment, which consisted primarily of machinery used in the manufacture of cigarettes, RAI utilized internal engineering resources and external vendor experts familiar with pricing for similar machinery on the secondary market. The fair value of long-term retirement benefits represents the funded status of the employee benefit plans assumed by RAI in the Lorillard Merger. RAI engaged its actuaries to determine the fair value of the projected benefit obligations at the date of the Lorillard Merger utilizing management's assumptions and estimates relative to the benefit plans acquired. For the fair value of benefit plan assets, an independent valuation expert was engaged, in addition to internal treasury resources, to project the fair value of the benefit plan assets at the Lorillard Merger date.

For further information related to accounting for the Lorillard Merger and Divestiture, see note 2.

Cash and Cash Equivalents

Cash balances are recorded net of book overdrafts when a bank right-of-offset exists. All other book overdrafts are recorded in accounts payable. Cash equivalents may include money market funds, commercial paper and time deposits in major institutions to minimize investment risk. As short-term, highly liquid investments readily convertible to known amounts of cash, with remaining maturities of three months or less at the time of purchase, cash equivalents have carrying values that approximate fair values.

Fair Value Measurement

RAI determines the fair value of assets and liabilities using a fair value hierarchy that distinguishes between market participant assumptions based on market data obtained from sources independent of the reporting entity, and the reporting entity's own assumptions about market participant assumptions based on the best information available in the circumstances.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, essentially an exit price.

The levels of the fair value hierarchy are:

Level 1: inputs are quoted prices, unadjusted, in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.

Level 2: inputs are other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. A Level 2 input must be observable for substantially the full term of the asset or liability.

Level 3: inputs are unobservable and reflect the reporting entity's own assumptions about the assumptions that market participants would use in pricing the asset or liability.

RAI sponsors a number of non-contributory defined benefit pension plans covering certain employees of RAI and its subsidiaries, and holds investments in plan assets to support these obligations. For additional information regarding the fair value of these plan assets, see note 16.

Inventories

Inventories are stated at the lower of cost or market. The cost of RJR Tobacco's leaf tobacco inventories is determined principally under the last-in, first-out, or LIFO, method and is calculated at the end of each year. The cost of work in process and finished goods includes materials, direct labor, variable costs and overhead and full absorption of fixed manufacturing overhead. Stocks of tobacco, which have an operating cycle that exceeds 12 months due to aging requirements, are classified as current assets, consistent with recognized industry practice. The remaining inventories not valued under LIFO are valued under the first-in, first-out method.

Long-lived Assets

Long-lived assets, such as property, plant and equipment, trademarks and other intangible assets with finite lives, are reviewed for impairment whenever events or changes in circumstances indicate that the book value of the asset may not be recoverable.

Impairment of the carrying value of long-lived assets would be indicated if the best estimate of future undiscounted cash flows expected to be generated by the asset grouping is less than its carrying value. If an impairment is indicated, any loss is measured as the difference between estimated fair value and carrying value and is recognized in operating income.

Property, Plant and Equipment

Property, plant and equipment are recorded at cost and depreciated using the straight-line method over the estimated useful lives of the assets. Useful lives range from 20 to 50 years for buildings and improvements, and from 3 to 30 years for machinery and equipment. The cost and related accumulated depreciation of assets sold or retired are removed from the accounts and the gain or loss on disposition is recognized in operating income. Depreciation expense was $100 million, $104 million and $95 million for the years ended December 31, 2016, 2015 and 2014, respectively.

Software Costs

Computer software and software development costs incurred in connection with developing or obtaining computer software for internal use that has an extended useful life are capitalized. These costs are amortized over their estimated useful life, which is typically five years or less. The following is a summary of balances and expenses for software costs as of and for the years ended December 31:

Balances:

	2016	2015
Unamortized software costs balance	$49	$37
Software costs — capitalized or included in construction-in-process	27	13

Expenses:

	2016	2015	2014
Software amortization expense	$14	$17	$15

Intangible Assets

Intangible assets include goodwill, trademarks and other intangible assets and are capitalized when acquired. The determination of fair value involves considerable estimates and judgment. In particular, the fair value of a reporting unit involves, among other things, developing forecasts of future cash flows, determining an appropriate discount rate, and when goodwill impairment is implied, determining the fair value of individual assets and liabilities, including unrecorded intangibles. Although RAI believes it has based its impairment testing of its intangible assets on reasonable estimates and assumptions, the use of different estimates and assumptions could result in materially different results. If the current legal and regulatory environment, business or competitive climate worsens, or RAI's operating companies' strategic initiatives adversely affect their financial performance, the fair value of goodwill, trademarks and other intangible assets could be impaired in future periods. Goodwill, trademarks and other intangible assets with indefinite lives are not amortized, but are tested for impairment annually, in the fourth quarter, and more frequently if events and circumstances indicate that the asset might be impaired.

Finite lived trademarks and acquired customer lists are amortized using the straight-line method over their remaining useful lives, of 2 to 19 years, consistent with the pattern of economic benefits estimated to be received.

Revenue Recognition

Revenue from product sales is recognized when persuasive evidence of an arrangement exists, delivery has occurred, the seller's price to the buyer is fixed or determinable, and collectability is reasonably assured. These criteria are generally met when title and risk of loss pass to the customer. Payments received in advance of shipments are deferred and recorded in other accrued liabilities until shipment occurs. Certain sales of leaf to a

related party, considered as bill-and-hold for accounting purposes, are recorded as deferred revenue when all of the above revenue recognition criteria are met except delivery, postponed at the customer's request. Revenue is subsequently recognized upon delivery. The revenues recorded are presented net of excise tax collected on behalf of government authorities.

Shipping and handling costs are classified as cost of products sold. Net sales include certain sales incentives, including retail discounting, promotional allowances and coupons.

Cost of Products Sold

RJR Tobacco (itself, and as successor by merger to Lorillard Tobacco) and SFNTC are participants in the Master Settlement Agreement, referred to as the MSA, and RJR Tobacco (itself, and as successor by merger to Lorillard Tobacco) is a participant in the other state settlement agreements with the States of Mississippi, Florida, Texas and Minnesota, which together with the MSA are collectively referred to as the State Settlement Agreements. RJR Tobacco's and SFNTC's obligations and the related expense charges under these agreements are subject to adjustments based upon, among other things, the volume of cigarettes sold by the operating subsidiaries, their relative market share, and their operating profit and inflation. Since relative market share is based on cigarette shipments, the best estimate of the allocation of charges to RJR Tobacco and SFNTC under these agreements is recorded in cost of products sold as the products are shipped. Included in these adjustments is the MSA non-participating manufacturer adjustment, referred to as the NPM Adjustment, that potentially reduces the annual payment obligation of RJR Tobacco, SFNTC and other participating manufacturers, referred to as the PMs. Adjustments to these estimates are recorded in the period that the change becomes probable and the amount can be reasonably estimated. American Snuff Co. is not a participant in the State Settlement Agreements.

Cost of products sold includes, among other expenses, the expenses for the State Settlement Agreements; the user fees charged by the U.S. Food and Drug Administration, referred to as the FDA; and the federal tobacco quota buyout that expired in 2014. These expenses were as follows for the years ended December 31:

	2016	2015	2014
State Settlement Agreements	$2,727	$2,403	$1,917
FDA user fees	194	174	135
Federal tobacco quota buyout	—	—	163

In 2012, RJR Tobacco, Lorillard Tobacco, SFNTC and certain other participating manufacturers, referred to as the PMs, entered into a term sheet, referred to as the Term Sheet, with 17 states, the District of Columbia and Puerto Rico to settle certain claims related to the NPM Adjustment. The Term Sheet resolved claims related to volume years from 2003 through 2012 and puts in place a revised method to determine future adjustments from 2013 forward. Subsequently, five additional states joined the Term Sheet, including two states that were found to not have diligently enforced their qualifying statutes in 2003. The parties to the Term Sheet represent an allocable share of 49.87%.

In June 2014, two additional states agreed to settle the NPM Adjustment disputes on similar terms as set forth in the Term Sheet, except for certain provisions related to the determination of credits to be received by the PMs. RJR Tobacco and SFNTC, collectively, will receive credits, currently estimated to total approximately $170 million, with respect to their NPM Adjustment claims from 2003 through 2012. The credits related to these two states will be applied against annual payments under the MSA over a five-year period effectively beginning with the April 2014 MSA payment. As a result, expenses for the MSA were reduced by $34 million for the year ended December 31, 2014. As a result of the Lorillard Tobacco Merger, RJR Tobacco will receive approximately $5 million of additional credits, attributable to Lorillard Tobacco, which will be applied against annual MSA payments through 2018.

As a result of meeting the performance requirements associated with the Term Sheet, RJR Tobacco and Santa Fe, collectively, recognized additional credits of $295 million, $282 million and $311 million for the years ended December 31, 2016, 2015 and 2014, respectively. Credits recognized in the years ended December 31, 2016 and 2015, include the benefit of the additional credits received as a result of the Lorillard Tobacco Merger. RJR Tobacco expects to recognize additional credits through 2017.

In September 2013, the Arbitration Panel ruled six states had not diligently enforced their qualifying statutes in 2003 related to the NPM Adjustment. Two of the six states subsequently joined the Term Sheet in 2014. In 2015, three of the states dropped their challenge of the finding of non-diligence and in 2016, the remaining state dropped its challenge. As such, a portion of the potential recovery from those states was certain and estimable, and RJR Tobacco recognized $6 million and $93 million as a reduction of cost of products sold for the years

ended December 31, 2016 and 2015, respectively. A final issue regarding the judgment reduction method adopted by the Arbitration Panel was being contested in these four states. In 2016, the U.S. Supreme Court denied RJR Tobacco's petition for writ of certiorari against two states, thus eliminating RJR Tobacco's remaining recovery from these states. The final outcome in the remaining two states is uncertain.

In October 2015, RJR Tobacco, SFNTC and certain other PMs entered into a settlement agreement, referred to as the NY Settlement Agreement, with the State of New York to settle certain claims related to the NPM Adjustment. The NY Settlement Agreement resolves NPM Adjustment claims related to payment years from 2004 through 2014, providing RJR Tobacco and SFNTC, collectively, with credits, of approximately $290 million, plus interest, subject to meeting various performance obligations. These credits will be applied against annual payments under the MSA over a four-year period, which commenced with the April 2016 MSA payment. RJR Tobacco and Santa Fe, collectively, recognized credits of $95 million and $15 million as a reduction to costs of products sold for the years ended December 31, 2016 and 2015, respectively. In addition, the NY Settlement Agreement put in place a new method to determine future adjustments from 2015 forward as to New York.

For additional information related to the NPM Adjustment settlement, see "— Litigation Affecting the Cigarette Industry — State Settlement Agreements — Enforcement and Validity; Adjustments" in note 13.

Advertising

Advertising costs, which are expensed as incurred, were $80 million, $140 million and $140 million for the years ended December 31, 2016, 2015 and 2014, respectively.

Research and Development

Research and development costs, which are expensed as incurred, were $101 million, $107 million and $88 million for the years ended December 31, 2016, 2015 and 2014, respectively.

Income Taxes

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Interest and penalties related to uncertain tax positions are accounted for as tax expense. Federal income taxes for RAI and its subsidiaries are calculated on a consolidated basis. State income taxes for RAI and its subsidiaries are primarily calculated on a separate return basis.

RAI accounts for uncertain tax positions which require that a position taken or expected to be taken in a tax return be recognized in the financial statements when it is more likely than not (a likelihood of more than 50%) that the position would be sustained upon examination by tax authorities. A recognized tax position is then measured at the largest amount of benefit that is greater than 50% likely of being realized upon ultimate settlement.

Stock-Based Compensation

Stock-based compensation expense is recognized for all forms of share-based payment awards, including shares issued to employees under restricted stock units.

Litigation

RAI discloses information concerning litigation for which an unfavorable outcome is more than remote. RAI and its subsidiaries record their legal expenses and other litigation costs and related administrative costs as selling, general and administrative expenses as these costs are incurred. RAI and its subsidiaries will record any loss related to litigation at such time as an unfavorable outcome becomes probable and the amount can be reasonably estimated on an individual case-by-case basis. When the reasonable estimate is a range, the recorded loss will be the best estimate within the range. If no amount in the range is a better estimate than any other amount, the minimum amount of the range will be recorded. For additional information related to litigation, see note 13.

Pension and Postretirement

Pension and postretirement benefits require balance sheet recognition of the net asset or liability for the overfunded or underfunded status of defined benefit pension and postretirement benefit plans, on a plan-by-plan basis, and recognition of changes in the funded status in the year in which the changes occur.

Actuarial (gains) losses are changes in the amount of either the benefit obligation or the fair value of plan assets resulting from experience different from that assumed or from changes in assumptions. Differences between actual results and actuarial assumptions are accumulated and recognized as a mark-to-market adjustment, referred to as an MTM adjustment, to the extent such accumulated net (gains) losses exceed 10% of the greater of the fair value of plan assets or benefit obligations, referred to as the corridor. Net (gains) losses outside the corridor are generally recognized annually as of December 31, or when a plan is remeasured during an interim period.

Prior service costs (credits) of pension benefits, which are changes in benefit obligations due to plan amendments, are amortized on a straight-line basis over the average remaining service period for active employees, or average remaining life expectancies for inactive employees if most of the plan obligations are due to inactive employees. Prior service costs (credits) of postretirement benefits, which are changes in benefit obligations due to plan amendments, are amortized on a straight-line basis over the expected service period to full eligibility age for active employees, or average remaining life expectancies for inactive employees if most of the plan obligations are due to inactive employees.

Recently Adopted Accounting Pronouncements

In April 2015, the FASB issued an Accounting Standards Update, referred to as ASU, 2015-03, *Simplifying the Presentation of Debt Issuance Costs.* The amended guidance requires debt issuance costs to be presented as a direct reduction of the debt liability with which it is associated similar to the way debt discounts are presented. The amended guidance did not change the requirement to amortize the costs as interest expense over the life of the associated debt. At RAI's election, and as permitted in ASU 2015-15, *Interest—Imputation of Interest (Subtopic 835-30),* the unamortized debt issuance costs associated with its credit facility are included in other assets and deferred charges in the balance sheets. The guidance, which required retrospective application, was effective for RAI for interim and annual reporting periods, beginning January 1, 2016, and resulted in a $68 million and $92 million reclassification of debt issuance costs for the years ended December 31, 2016 and 2015, respectively. The adoption of the amended guidance did not have an impact on RAI's results of operations or cash flows.

In April 2015, the FASB issued ASU 2015-05, *Internal Use Software,* for determining if an arrangement for cloud services includes a license of software. This new guidance does not change the accounting standard for cloud service providers, but does base the criteria for determining if a license of software is part of the arrangement based on the existing guidance. If a license of software is present in the arrangement, the fee associated with the license portion will be capitalized when the criteria for capitalization of internal-use software are met. This guidance was effective for interim and annual periods beginning January 1, 2016. As permitted, RAI adopted the guidance on a prospective basis and, accordingly, its adoption did not have a material impact on RAI's results of operations, cash flows or financial position.

In May 2015, the FASB issued ASU 2015-07, *Fair Value Measurement — Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent),* eliminating the requirement to categorize investments in the fair value hierarchy if their fair value is measured at net asset value per share (or its equivalent) using the practical expedient in the FASB's fair value measurement guidance. The amended guidance, which requires retrospective application, is effective for financial statements issued for the fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. As permitted, RAI adopted this amended guidance as of January 1, 2016, with retrospective application to the fair value hierarchy as of December 31, 2015. As of December 31, 2016, the reduction of Level 2 and Level 3 investments was $785 and $670 million, respectively. The retrospective application resulted in the removal of certain investments classified as Level 2 and Level 3 from the fair value hierarchy, resulting in a reduction of Level 2 and Level 3 investments of $819 million and $679 million, respectively, as of December 31, 2015. The adoption of the amended guidance did not have an impact on RAI's results of operations, cash flows or financial position. For additional information, see note 16.

In November 2015, the FASB issued ASU 2015-17, *Balance Sheet Classification of Deferred Taxes,* requiring that all deferred income tax balances in the consolidated balance sheets be classified as non-current.

The amended guidance is effective for financial statements issued for fiscal years beginning after December 15, 2016, and interim periods within those fiscal years. As permitted, RAI adopted the amended guidance as of December 31, 2016, with retrospective application to the consolidated balance sheet as of December 31, 2015. The retrospective application resulted in a reclassification of deferred income taxes, net in current assets to deferred income taxes, net in long-term liabilities of approximately $900 million and $1 billion for the years ended December 31, 2016 and 2015, respectively. The adoption of the amended guidance did not have an impact on RAI's results of operations or cash flows.

Recently Issued Accounting Pronouncements

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers,* which replaces most existing GAAP revenue recognition guidance. The effective date for adoption of this guidance was subsequently deferred to interim and annual reporting periods beginning after December 15, 2017. In 2016, the FASB issued supplemental implementation guidance related to ASU 2014-09, including:

- ASU 2016-08, *Revenue from Contracts with Customers: Principal versus Agent Considerations (Reporting Revenue Gross versus Net),* which is intended to provide further clarification on the application of the principal versus agent implementation;
- ASU 2016-10, *Revenue from Contracts with Customers: Identifying Performance Obligations and Licensing,* which is intended to clarify the guidance for identifying promised goods or services in a contract with a customer;
- ASU 2016-11, *Revenue Recognition (Topic 605) and Derivative and Hedging (Topic 815) – Rescission of SEC Guidance Because of Accounting Standards Updates 2014-09 and 2014-16 Pursuant to Staff Announcements at the March 3, 2016 EITF Meeting;*
- ASU 2016-12, *Revenue Recognition from Contracts with Customers: Narrow-Scope Improvements and Practical Expedients,* which amends certain aspects of ASU 2014-09 to address certain implementation issues; and
- ASU 2016-20, *Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers*, which includes thirteen technical corrections and improvements affecting narrow aspects of the guidance issued in ASU 2014-09.

During 2016, RAI substantially completed its assessment of ASU 2014-09 to identify any potential changes in the amount and timing of revenue recognition for its current contracts and the expected impact on its business processes, systems and controls. Based on this assessment, RAI does not expect the adoption of ASU 2014-09 to have a material impact on RAI's results of operations, cash flows and financial position. The new guidance may be applied retrospectively to each prior period presented (full retrospective method) or retrospectively with the cumulative effect recognized as of the date of initial application (modified retrospective method). RAI is continuing to evaluate the impact of ASU 2014-09 primarily to determine the transition method to utilize at adoption and the additional disclosures required. The new guidance will be adopted effective January 1, 2018.

In January 2016, the FASB issued ASU 2016-01, *Recognition and Measurement of Financial Assets and Liabilities,* which supersedes existing guidance to classify equity securities with readily determinable fair values into different categories and requires equity securities to be measured at fair value with changes in the fair value recognized through net income. An entity's equity investments that are accounted for under the equity method of accounting or result in consolidation of an investee are not included within the scope of this amended guidance. The amendments allow equity investments that do not have readily determinable fair values to be remeasured at fair value either upon the occurrence of an observable price change or upon identification of impairment. The amended guidance is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. As permitted, RAI adopted the amended guidance as of January 1, 2017, and it is not expected to have a material impact on RAI's results of operations, cash flows and financial position.

In February 2016, the FASB issued ASU 2016-02, *Leases,* requiring lessees to recognize lease assets and lease liabilities in the balance sheet and disclose key information about leasing arrangements, such as information about variable lease payments and options to renew and terminate leases. The amended guidance will require both operating and finance leases to be recognized in the balance sheet. Additionally, the amended guidance aligns lessor accounting to comparable guidance in Accounting Standard Codification Topic 606, *Revenue from Contracts with Customers.* The amended guidance is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. RAI expects to adopt the amended guidance in ASU

2016-02 effective January 1, 2019, and is currently early in its assessment of the impact of this new standard. However, if at adoption RAI has similar obligations for leases as it had at December 31, 2016, RAI believes this guidance will not have a material impact on its results of operations, cash flows and financial position. RAI expects to substantially complete its assessment of the new standard during 2017.

In March 2016, the FASB issued ASU 2016-09, *Improvements to Employee Share-Based Payment Accounting,* which simplifies several aspects of the accounting for employee share-based payment transactions, including accounting for income tax, forfeitures, statutory tax withholding requirements, classifications of awards as either equity or liabilities, and classification of taxes in the statement of cash flows. The amended guidance also requires an entity to record excess tax benefits and deficiencies in the income statement rather than as a change to paid-in capital. The amended guidance is effective for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. RAI adopted this amended guidance effective January 1, 2017, and determined that it will not have a material impact to RAI's results of operations, cash flows and financial position. If adoption of this amended guidance occurred in 2016, the primary impact to RAI's results of operations would have been a reduction in the provision for income taxes of $28 million, $17 million and $12 million, for the years ended December 31, 2016, 2015 and 2014, respectively. Early adoption would have also resulted in a reclassification of cash from financing activities to cash from operations on the statement of cash flows for the same amounts. The impact of the new guidance will be applied prospectively.

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments — Credit Losses,* which replaces the current incurred loss impairment methodology for recognizing credit losses for financial instruments with a methodology that reflects expected credit losses and requires consideration for a broader range of reasonable and supportable information for estimating credit losses. The amended guidance is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. Early adoption is permitted for fiscal years beginning after December 15, 2018. RAI has not yet determined if it will adopt this amended guidance earlier than the effective date and has not initiated its assessment of the impact that this guidance will have on its results of operations, cash flows and financial position.

In August 2016, the FASB issued ASU 2016-15, *Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments,* addressing eight specific cash flow issues in an effort to reduce diversity in practice. The amended guidance is effective for fiscal years beginning after December 31, 2017, and for interim periods within those years. RAI will adopt this amended guidance effective January 1, 2018. The amended guidance will not have a material impact on RAI's statements of cash flows.

In November 2016, the FASB issued ASU 2016-18, *Statement of Cash Flows — Restricted Cash,* addressing the diversity in practice that exists regarding the classification and the presentation of changes in restricted cash on the statement of cash flows. The amended guidance requires that a statement of cash flows explain the change during the period in the total of cash, cash equivalents, restricted cash and restricted cash equivalents. The amended guidance does not provide a definition of restricted cash or restricted cash equivalents. The amended guidance is effective for fiscal years beginning after December 15, 2017, and for interim periods within those years. RAI will adopt this amended guidance effective January 1, 2018. The amended guidance will not have a material impact on RAI's statements of cash flows.

Note 2 — Lorillard Merger, Divestiture and BAT Share Purchase

Lorillard Merger

On June 12, 2015, the Lorillard Merger was completed, with Lorillard surviving as a wholly owned subsidiary of RAI. Each outstanding share of Lorillard common stock was converted into the right to receive (1) 0.2909 of a share of RAI common stock, prior to giving effect to RAI's 2015 two-for-one stock split, referred to as the stock split, plus (2) $50.50 in cash (the foregoing collectively referred to as the Lorillard Merger Consideration). RAI issued 104,706,847 shares of RAI common stock at a price of $72.15 per share, prior to giving effect to the stock split, to Lorillard shareholders in the Lorillard Merger. After giving effect to the stock split, RAI issued 209,413,694 shares of RAI common stock to Lorillard shareholders in the Lorillard Merger.

As a part of the Lorillard Merger, RAI acquired the premium cigarette brand, NEWPORT, which is the top-selling menthol and second largest selling cigarette brand overall in the United States. In addition to NEWPORT, RAI acquired three additional brand families marketed under the KENT, TRUE and OLD GOLD brand names.

In accordance with ASC 805, the Lorillard Merger was accounted for using the acquisition method of accounting with RAI considered the acquirer of Lorillard. RAI recorded assets acquired, including identifiable intangible assets, and liabilities assumed, from Lorillard at their respective fair values at the date of completion

of the Lorillard Merger. The excess of the purchase price over the net fair value of such assets and liabilities was recorded as goodwill.

Purchase Price

The purchase price of $25.8 billion consisted of the Lorillard Merger Consideration together with the payment of certain Lorillard equity awards and certain change of control payments as follows:

Fair value of RAI common stock issued	$ 7,555
Cash paid to Lorillard shareholders at $50.50 per share	18,205
Cash paid for Lorillard stock options and stock appreciation rights	73
Purchase price	$25,833

Allocation of Purchase Price

The purchase price as allocated to the assets acquired and liabilities assumed in the Lorillard Merger is set forth below:

	Final Allocation
Assets	
Cash and cash equivalents	$ 1,058
Short-term investments	347
Accounts and other receivables	47
Inventories	576
Income taxes receivable	135
Other current assets	1,673
Property, plant and equipment	82
Trademarks and other intangible assets	27,443
Goodwill	9,853
Other assets and deferred charges	207
Liabilities	
Tobacco settlement accruals	755
Other current liabilities	602
Long-term debt (less current maturities)	3,895
Deferred income taxes, net	9,998
Long-term retirement benefits (less current portion)	274
Other noncurrent liabilities	64
Allocation of purchase price	$25,833

The allocation of the purchase price reflected in the accompanying financial statements was based upon estimates and assumptions. The $9,853 million allocated to goodwill, which was primarily attributable to the establishment of deferred tax liabilities associated with the trademarks acquired and the expected synergies from future growth, was allocated to the RJR Tobacco segment, and is non-deductible for tax purposes.

The results of operations of the acquired Lorillard brands are included in RAI's consolidated statements of income from the date of acquisition and include $2.7 billion of total net sales for the year ended December 31, 2015, and are included in the RJR Tobacco segment's financial results. RAI does not maintain discrete financial information on a brand basis in order to determine the impact to net income for the periods presented. In addition, as a result of the acquisition, $9 billion of debt was issued and approximately $3.9 billion of Lorillard Tobacco debt, at fair value, was assumed. The interest expense related to the acquisition was approximately $282 million for the year ended December 31, 2015.

Divestiture

On June 12, 2015, the Divestiture was completed, and ITG acquired the cigarette brands WINSTON, KOOL and SALEM, previously owned by RAI subsidiaries and included in the RJR Tobacco segment, as well as the cigarette brand MAVERICK and the "e-vapor" brand blu (including SKYCIG), previously owned by Lorillard

subsidiaries, and other assets and certain liabilities, including inventory, fixed assets and employee benefit plans, for an aggregate purchase price of approximately $7.1 billion. A summary of the pre-tax gain is as follows:

Purchase price	$ 7,056
Net assets and liabilities divested	(2,026)
Goodwill associated with divested RJR Tobacco brands	(1,849)
Gain on divestiture	$ 3,181

BAT Share Purchase and Other

In connection with the Lorillard Merger and Divestiture, on July 15, 2014, RAI, BAT, and for limited purposes only, B&W, entered into a subscription and support agreement, referred to as the Subscription Agreement, pursuant to which BAT agreed to subscribe for and purchase, directly or indirectly through one or more of its wholly owned subsidiaries, simultaneously with the completion of the Lorillard Merger and at a price of approximately $4.7 billion in the aggregate, shares of RAI common stock such that BAT, directly or indirectly through its affiliates, would maintain its approximately 42% beneficial ownership in RAI (the foregoing purchase is referred to as the BAT Share Purchase).

On June 12, 2015, concurrently with the completion of the Lorillard Merger and Divestiture and pursuant to the Subscription Agreement, BAT indirectly (through a wholly owned subsidiary) purchased 77,680,259 shares of RAI common stock, prior to giving effect to the stock split, for approximately $4.7 billion, which was sufficient for BAT and its subsidiaries collectively to maintain their approximately 42% beneficial ownership in RAI. Upon completion of the transactions on June 12, 2015, BAT and its subsidiaries collectively owned 301,014,278 shares, prior to giving effect to the stock split, or approximately 42%, of RAI's outstanding common stock. After giving effect to the stock split, BAT indirectly purchased 155,360,518 shares of RAI common stock, and BAT and its subsidiaries collectively owned 602,028,556 shares of RAI common stock.

RAI financed the cash portion of the Lorillard Merger Consideration and related fees and expenses with (1) the net proceeds from a public offering of $9 billion aggregate principal amount of newly issued RAI senior notes, (2) the proceeds from the Divestiture, (3) the proceeds from the BAT Share Purchase and (4) available cash. Transaction related costs of $54 million and $38 million, for the years ended December 31, 2015 and 2014, respectively, were expensed as incurred and included in selling, general and administrative expenses in RAI's consolidated statements of income.

Note 3 — Sale of International Rights to the NATURAL AMERICAN SPIRIT Brand

On January 13, 2016, RAI, through the Sellers, completed the sale of the international rights to the NATURAL AMERICAN SPIRIT brand name and associated trademarks, along with the international companies that distributed and marketed the brand outside the United States, to JTI Holding in an all-cash transaction of approximately $5 billion and recognized a pre-tax gain of approximately $4.9 billion.

The purchase agreement, dated as of September 28, 2015, between the Sellers and JTI Holding, referred to as the 2015 Purchase Agreement, contains customary representations, warranties and covenants made by the Sellers and JTI Holding, and, for certain provisions, RAI and JTI, and contains indemnification provisions, subject to customary limitations, with respect to these and other matters, including potential litigation relating to specified claims. The 2015 Purchase Agreement also contains a guarantee of Sellers' obligations by RAI, and a guarantee of JTI Holding's obligations by JTI. Further, in the 2015 Purchase Agreement, RAI has agreed not to, and agreed to cause its controlled affiliates not to, engage in the business of producing, selling, distributing and developing natural, organic and additive-free combustible tobacco cigarettes and roll-your-own or make-your-own tobacco products outside of the United States, and JTI has agreed not to, and agreed to cause its controlled affiliates not to, engage in the conduct of such business in the United States, in each case, for five years following the closing of the transaction.

The transaction did not include the rights to the NATURAL AMERICAN SPIRIT brand name and associated trademarks in the U.S. market, U.S. duty-free locations, and U.S. territories or in U.S. military outlets, all of which have been retained by SFNTC. With this transaction completed, the international rights to nearly all of RAI's operating companies' cigarette trademarks are now owned by international tobacco companies.

The components of the pre-tax gain, which was recorded during the year ended December 31, 2016, were as follows:

Purchase price	$5,015
Net assets and liabilities divested	(154)
Gain on divestiture	$4,861

Note 4 — Fair Value Measurement

Fair Value of Financial Assets

Financial assets carried at fair value as of December 31, were as follows:

	2016				2015			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Cash and cash equivalents:								
Cash equivalents	$2,006	$—	$—	$2,006	$2,454	$—	$—	$2,454
Short-term investments:								
Corporate debt securities	—	—	—	—	—	96	—	96
U.S. Government agency obligations	—	—	—	—	—	43	—	43
Commercial paper	—	—	—	—	—	10	—	10
Other assets and deferred charges:								
Auction rate securities	—	—	—	—	—	—	79	79
Mortgage-backed security	—	—	—	—	—	—	10	10
Marketable equity security	—	—	—	—	1	—	—	1
Interest rate swaps	—	—	—	—	—	53	—	53

There were no transfers between the levels during the years ended December 31, 2016 and 2015.

As of December 31, 2015, RAI's short-term investments included corporate debt securities, U.S. Government agency obligations and commercial paper. The fair value of these investments, classified as Level 2, utilized quoted prices for identical assets in less active markets or quoted prices for similar assets in active markets. The fair value of the interest rate swaps, classified as Level 2, utilized a market approach model using the notional amount of the interest rate swaps and observable inputs of time to maturity and market interest rates. All investments classified as short-term investments as of December 31, 2015, were sold or matured and an immaterial loss was recorded during the year ended December 31, 2016.

As of December 31, 2015, RAI had investments in auction rate securities linked to corporate credit risk, in auction rate securities related to financial insurance companies, and in a mortgage-backed security. The fair value of these investments, each classified as Level 3, was determined with pricing models using inputs that were unobservable and assumptions made by RAI about the assumptions that market participants would use in pricing the assets. In addition, RAI had an investment in a marketable equity security classified as Level 1. During the year ended December 31, 2016, the auction rate securities related to financial insurance companies, the marketable equity security and mortgage-backed security were sold, and an immaterial loss was recognized. The auction rate securities linked to corporate credit risk were called by the issuers at their par value of $95 million. No other-than-temporary impairment losses were recognized for the years ended December 31, 2016 and 2015, respectively. Any unrealized gains and losses, net of tax, related to investments held at December 31, 2015, were included in accumulated other comprehensive loss in RAI's consolidated balance sheet as of December 31, 2015.

Interest Rate Management

From time to time, RAI and RJR have used interest rate swaps to manage interest rate risk on a portion of their respective debt obligations.

As part of the Lorillard Tobacco Merger, RJR Tobacco assumed fixed to floating interest rate swap agreements that Lorillard Tobacco designated as fair value hedges of its 8.125% notes due in 2019. Under the swap agreements, RJR Tobacco received interest based on a fixed rate of 8.125% and paid interest based on a

floating one-month LIBOR rate plus a spread of 4.625%. The net settlement reduced interest expense by approximately $3 million and $13 million for the years ended December 31, 2016 and 2015 respectively. During 2016, RJR Tobacco terminated these interest rate swap agreements and received $66 million in cash. The remaining fair value adjustment of $7 million for the notes designated as the hedging instrument is being amortized as a reduction of interest expense over the expected remaining life of the notes. As of December 31, 2016, RAI, RJR and RJR Tobacco had no outstanding interest rate swaps. See notes 2 and 12 for additional information related to interest rate swap agreements.

Note 5 — Intangible Assets

The changes in the carrying amounts of goodwill by segment were as follows:

	RJR Tobacco	Santa Fe	American Snuff	All Other	Consolidated
Balance as of December 31, 2014					
Goodwill	$ 9,065	$197	$2,501	$ 44	$11,807
Less: accumulated impairment charges	(3,763)	—	(28)	—	(3,791)
Net goodwill balance as of December 31, 2014	5,302	197	2,473	44	8,016
2015 Activity					
Lorillard Merger goodwill	9,853	—	—	—	9,853
Divestiture goodwill	(1,849)	—	—	—	(1,849)
Reclassified to assets held for sale (1)	—	—	—	(27)	(27)
Balance as of December 31, 2015					
Goodwill	17,069	197	2,501	17	19,784
Less: accumulated impairment charges	(3,763)	—	(28)	—	(3,791)
Net goodwill balance as of December 31, 2015	13,306	197	2,473	17	15,993
2016 Activity					
Foreign currency translation	—	—	—	(1)	(1)
Balance as of December 31, 2016					
Goodwill	17,069	197	2,501	16	19,783
Less: accumulated impairment charges	(3,763)	—	(28)	—	(3,791)
Net goodwill balance as of December 31, 2016	$13,306	$197	$2,473	$ 16	$15,992

(1) Related to the sale of international rights to the NATURAL AMERICAN SPIRIT brand. See note 3.

The changes in the carrying amounts of indefinite-lived intangible assets by segment not subject to amortization were as follows:

	RJR Tobacco		Santa Fe	American Snuff	All Other	Consolidated	
	Trademarks	Other	Trademarks	Trademarks	Other	Trademarks	Other
Balance as of December 31, 2014	$ 977	$ 99	$155	$1,136	$ 4	$ 2,268	$103
Trademarks acquired in Lorillard Merger	27,193	—	—	—	—	27,193	—
Trademarks divested	(344)	—	—	—	—	(344)	—
Other intangibles divested	—	(12)	—	—	—	—	(12)
Reclassified to assets held for sale (1)	—	—	(19)	—	(4)	(19)	(4)
Balance as of December 31, 2015	27,826	87	136	1,136	—	29,098	87
Balance as of December 31, 2016	$27,826	$ 87	$136	$1,136	$—	$29,098	$ 87

(1) Related to the sale of international rights to the NATURAL AMERICAN SPIRIT brand. See note 3.

The changes in the carrying amounts of finite-lived intangible assets by segment subject to amortization were as follows:

	RJR Tobacco		American Snuff	All Other	Consolidated	
	Trademarks	Other	Trademarks	Other	Trademarks	Other
Balance as of December 31, 2013	$18	$ 20	$ 8	$—	$26	$ 20
Amortization	(6)	(4)	(1)	—	(7)	(4)
Acquisition	—	15	—	—	—	15
Balance as of December 31, 2014	12	31	7	—	19	31
Trademarks acquired in Lorillard Merger	10	—	—	—	10	—
Customer lists acquired in Lorillard Merger	—	240	—	—	—	240
Amortization	(5)	(12)	(1)	—	(6)	(12)
Balance as of December 31, 2015	17	259	6	—	23	259
Intercompany transfer	—	(13)	—	13	—	—
Amortization	(5)	(17)	(1)	—	(6)	(17)
Balance as of December 31, 2016	$12	$229	$ 5	$13	$17	$242

Details of finite-lived intangible assets were as follows:

	December 31, 2016			December 31, 2015		
	Gross	Accumulated Amortization	Net	Gross	Accumulated Amortization	Net
Customer lists	$240	$ (19)	$221	$240	$ (7)	$233
Contract manufacturing agreement	151	(143)	8	151	(139)	12
Trademarks	124	(107)	17	124	(101)	23
Other intangibles	15	(2)	13	15	(1)	14
	$530	$(271)	$259	$530	$(248)	$282

The remaining amortization expense associated with finite-lived intangible assets is expected to be as follows:

Year	Amount
2017	$ 23
2018	22
2019	16
2020	15
2021	14
Thereafter	169
	$259

The impairment testing of trademarks in the fourth quarters of 2016, 2015 and 2014 assumed a rate of decline in projected net sales of certain brands, comparable with that assumed in RAI's strategic plan. The fair value of trademarks used in impairment testing was determined by an income approach using a discounted cash flow valuation model under a relief from royalty methodology. The relief-from-royalty model includes the estimates of the royalty rate that a market participant might assume, projected revenues and judgment regarding the discount rate applied to those estimated cash flows, with that discount rate being 10.0% during 2016, 2015 and 2014. The determination of the discount rate was based on a cost of equity model, using a risk-free rate, adjusted by a stock beta-adjusted risk premium and a size premium. As a result of these analyses, an impairment charge is recognized if the carrying value of a trademark exceeds its estimated fair value. No impairment charges were indicated for 2016, 2015 or 2014.

For the annual impairment testing of the goodwill of RAI's reporting units, each reporting unit's estimated fair value was compared with its carrying value. A reporting unit is an operating segment or one level below an operating segment. The determination of estimated fair value of each reporting unit was calculated primarily utilizing an income approach model, based on the present value of the estimated future cash flows of the reporting unit assuming a discount rate during each of 2016, 2015 and 2014 of 9.75% for each of RJR Tobacco

and American Snuff and 10.25% for Santa Fe. The determination of the discount rate was based on a weighted average cost of capital. Additionally, the aggregate estimated fair value of the reporting units, determined with the use of the income approach model, was compared with RAI's market capitalization. The estimated fair value of each reporting unit was substantially greater than its respective carrying value.

Note 6 — Asset Impairment and Exit Charges

In 2015, RAI announced that certain of its operating companies consolidated manufacturing operations for the VUSE Digital Vapor Cigarette. In addition to in-house production at RJR Tobacco's manufacturing facility, certain production of VUSE Solo cartridges was previously performed for RJR Vapor at a contractor's facility in Kansas. Since the fourth quarter of 2015, all production of VUSE Solo cartridges is performed at RJR Tobacco's facility, pursuant to a services agreement between RJR Tobacco and RJR Vapor. As a result of this consolidation, pre-tax asset impairment and exit charges of $99 million, consisting primarily of equipment, were recorded in the consolidated statements of income for the year ended December 31, 2015, and were allocated to All Other.

Note 7 — Income Per Share

The components of the calculation of income per share were as follows:

	For the Years Ended December 31,		
	2016	2015	2014
Income from continuing operations	$ 6,073	$ 3,253	$ 1,445
Income from discontinued operations	—	—	25
Net income	$ 6,073	$ 3,253	$ 1,470
Basic weighted average shares, in thousands	1,426,987	1,264,182	1,066,320
Effect of dilutive potential shares:			
Restricted stock units	2,946	3,533	3,620
Diluted weighted average shares, in thousands	1,429,933	1,267,715	1,069,940

Note 8 — Inventories

The major components of inventories at December 31 were as follows:

	2016	2015
Leaf tobacco	$1,436	$1,495
Other raw materials	77	110
Work in process	81	88
Finished products	165	173
Other	25	22
Total	1,784	1,888
LIFO allowance	(139)	(154)
	$1,645	$1,734

Inventories valued under the LIFO method were $791 million and $922 million at December 31, 2016 and 2015, respectively, net of the LIFO allowance. The LIFO allowance reflects the excess of the current cost of LIFO inventories at December 31, 2016 and 2015, over the amount at which these inventories were carried on the consolidated balance sheets. RAI recognized income of $15 million, $50 million and $2 million from LIFO inventory changes during 2016, 2015, and 2014, respectively.

Note 9 — Other Current Liabilities

Other current liabilities at December 31 included the following:

	2016	2015
Payroll and employee benefits	$ 268	$ 210
Pension and postretirement benefits	89	91
Marketing and advertising	155	213
Excise, franchise and property tax	172	217
Other	352	503
	$1,036	$1,234

Note 10 — Income Taxes

The components of the provision for income taxes from continuing operations for the years ended December 31 were as follows:

	2016	2015	2014
Current:			
Federal	$2,794	$3,313	$ 809
State and other	437	477	188
	3,231	3,790	997
Deferred:			
Federal	350	(597)	(151)
State and other	37	(62)	(29)
	387	(659)	(180)
	$3,618	$3,131	$ 817

Significant components of deferred tax assets and liabilities for the years ended December 31 included the following:

	2016	2015
Deferred tax assets:		
Pension and postretirement liabilities	$ 759	$ 916
Tobacco settlement accruals	955	1,088
Other accrued liabilities	169	175
Other noncurrent liabilities	210	283
Subtotal	2,093	2,462
Less: valuation allowance	—	(8)
	2,093	2,454
Deferred tax liabilities:		
LIFO inventories	(257)	(266)
Property and equipment	(290)	(259)
Trademarks and other intangibles	(10,972)	(11,002)
Other	(181)	(131)
	(11,700)	(11,658)
Net deferred tax asset (liability)	$ (9,607)	$ (9,204)

RAI had no federal capital loss carryforwards at December 31, 2016 and 2015, respectively.

As of December 31, 2016, no valuation allowance was established on deferred tax assets as RAI believes it is more likely than not that the deferred tax assets will be realized through the generation of future taxable income. At December 31, 2015, RAI had recorded a valuation allowance of $8 million to fully offset the deferred tax assets attributable to its Puerto Rico subsidiaries. In 2016, reorganization of the Puerto Rico business in connection with the Lorillard Merger and Divestiture resulted in the $8 million valuation allowance being reversed.

Pre-tax income for domestic and foreign continuing operations for the years ended December 31 consisted of the following:

	2016	2015	2014
Domestic (includes U.S. exports)	$9,610	$6,342	$2,235
Foreign	81	42	27
	$9,691	$6,384	$2,262

The differences between the provision for income taxes from continuing operations and income taxes computed at statutory U.S. federal income tax rates for the years ended December 31 were as follows:

	2016	2015	2014
Income taxes computed at the statutory U.S. federal income tax rate	$3,392	$2,233	$ 792
State and local income taxes, net of federal tax benefits	306	235	107
Domestic manufacturing deduction	(114)	(104)	(80)
Nondeductible goodwill	9	761	—
Other items, net	25	6	(2)
Provision for income taxes from continuing operations	$3,618	$3,131	$ 817
Effective tax rate	37.3%	49.0%	36.1%

The effective tax rate for 2016 was impacted by the sale of the international rights to the NATURAL AMERICAN SPIRIT brand name and associated trademarks, along with the international companies that distributed and marketed the brand outside the United States. The effective tax rate for 2015 was unfavorably impacted by an increase in tax attributable to nondeductible acquisition costs, nondeductible goodwill in the amount of $1,849 million associated with the Divestiture and an increase in uncertain tax positions, offset by a decrease in tax attributable to the release of a valuation allowance in the amount of $37 million and a reduction in state income taxes. The effective tax rate for 2014 was favorably impacted by a decrease in uncertain tax positions related to a federal audit settlement and an increase in the domestic manufacturing deduction, partially offset by an increase in tax attributable to nondeductible acquisition costs. The effective tax rate for each period differed from the federal statutory rate of 35% due to the domestic manufacturing deduction, state income taxes and certain nondeductible items.

The audit of the 2010 and 2011 tax years by the Internal Revenue Service was closed in 2014. A tax benefit of $25 million attributable to a decrease in uncertain tax positions was recorded in discontinued operations.

On December 19, 2014, the Tax Increase Prevention Act of 2014, referred to as the TIPA, was signed into law. The TIPA retroactively reinstated and extended the Federal Research and Development Tax Credit from January 1, 2014 to December 31, 2014. The impact of the TIPA did not significantly impact RAI's annual effective income tax rate in 2014.

On December 18, 2015, the Protecting Americans from Tax Hikes (PATH) Act, was signed into law. The PATH Act extends the research credit permanently, retroactive to January 1, 2015. The PATH Act did not significantly impact RAI's annual effective income tax rate in 2015.

At December 31, 2016, there were $393 million of accumulated and undistributed foreign earnings. Of this amount, RAI has invested $15 million and has plans to invest an additional $52 million overseas. RAI has recorded either current or deferred income taxes related to the $326 million of accumulated foreign earnings in excess of its historical and planned overseas investments.

The components of deferred tax benefits included in accumulated other comprehensive loss for the years ended December 31 were as follows:

	2016	2015
Retirement benefits	$215	$209
Long-term investments	—	10
Hedging instruments	—	6
Cumulative translation adjustment and other	25	31
	$240	$256

The accruals for gross unrecognized income tax benefits, including interest and penalties, reflected in other noncurrent liabilities for the years ended December 31 were as follows:

	2016	2015
Unrecognized tax benefits	$118	$ 97
Accrued interest	13	17
Accrued penalties	7	8
	$138	$122

A reconciliation of the gross unrecognized income tax benefits is as follows:

	2016	2015	2014
Balance at beginning of year	$ 97	$27	$ 62
Gross increases related to current period tax positions	30	28	5
Gross increases related to tax positions in prior periods	3	46	—
Gross decreases related to tax positions in prior periods	(3)	(1)	(31)
Gross decreases related to audit settlements	(2)	—	(6)
Gross decreases related to lapse of applicable statute of limitations	(7)	(3)	(3)
Balance at end of year	$118	$97	$ 27

At December 31, 2016, $92 million of unrecognized income tax benefits including interest and penalties, if recognized, would decrease RAI's effective tax rate.

For the year ended December 31, 2016, the gross increases in unrecognized income tax benefits related to tax positions in the current period are primarily attributable to the sale of the international rights to the NATURAL AMERICAN SPIRIT brand name and associated trademarks, along with the international companies that distributed and marketed the brand outside the United States.

RAI and its subsidiaries are subject to income taxes in the United States, certain foreign jurisdictions and multiple state jurisdictions. A number of years may elapse before a particular matter, for which RAI has established an accrual, is audited and finally resolved. The number of years with open tax audits varies depending on the tax jurisdiction.

RAI and its subsidiaries file income tax returns in the U.S. federal and various state and foreign jurisdictions. The U.S. federal statute of limitations remains open for the year 2013 and forward. State and foreign jurisdictions have statutes of limitations generally ranging from three to five years. Certain of RAI's state tax returns are currently under examination by various states as part of routine audits conducted in the ordinary course of business.

Note 11 — Credit Agreement

Credit Agreement

In December 2014, RAI entered into a credit agreement, referred to as the Credit Agreement, with a syndicate of lenders, providing for a five-year, $2 billion senior unsecured revolving credit facility, which may be increased to $2.35 billion at the discretion of the lenders upon the request of RAI. The Credit Agreement replaced RAI's four-year, $1.35 billion senior unsecured revolving credit facility dated October 8, 2013.

Subject to certain conditions, RAI is able to use the revolving credit facility under the Credit Agreement for borrowings and issuances of letters of credit at its option, subject to a $300 million sublimit on the aggregate amount of letters of credit. Issuances of letters of credit reduce availability under such revolving credit facility.

The original maturity date of the Credit Agreement was December 18, 2019. Pursuant to the maturity date extension provision of the Credit Agreement, the requisite lenders have agreed on two separate occasions upon RAI's request, to extend the maturity date of the Credit Agreement by 12 months. Pursuant to the Credit Agreement's second and sole remaining maturity date extension provision, the lenders agreed, in November 2016 and at RAI's request, to extend the maturity date of the Credit Agreement by 12 months, to December 18, 2021. In connection with the maturity date extension, RAI and its guarantor subsidiaries entered into a second amendment to the Credit Agreement, dated November 4, 2016, with additional provisions added to address new European economic area regulations that give European bank regulators powers to eliminate, convert to equity or otherwise modify failing European financial institutions' unsecured liabilities, including loan commitments.

The Credit Agreement contains certain customary restrictive covenants, and two financial covenants — a consolidated leverage ratio covenant and a consolidated interest coverage ratio covenant. The Credit Agreement contains customary events of default, including upon a change in control, as defined therein, which could result in the acceleration of all amounts and cancellation of all commitments outstanding under the Credit Agreement.

The lenders' obligations under the Credit Agreement to fund borrowings are subject to the accuracy of RAI's representations and warranties and the absence of any default, provided, however, that the accuracy of RAI's representation as to the absence of any material adverse effect, as defined in the Credit Agreement, is not a condition to borrowing for the purpose of refinancing any maturing commercial paper.

Under the terms of the Credit Agreement, RAI is required to pay a facility fee per annum of between 0.100% and 0.275%, based generally on the ratings of RAI's senior, unsecured, long-term indebtedness, on the lender commitments in respect of the revolving credit facility thereunder.

Borrowings under the Credit Agreement bear interest, at the option of RAI, at a rate equal to an applicable margin based generally on the ratings of RAI's senior, unsecured, long-term indebtedness, plus:

- the alternate base rate, which is the higher of (1) the federal funds effective rate from time to time plus 0.5%, (2) the prime rate and (3) the reserve adjusted eurodollar rate for a one month interest period plus 1%; or
- the eurodollar rate, which is the reserve adjusted rate at which eurodollar deposits for one, two, three or six months are offered in the interbank eurodollar market.

Overdue principal outstanding under the revolving credit facility under the Credit Agreement bears interest at a rate equal to the rate then in effect with respect to such borrowings, plus 2.0% per annum. Any amount besides principal that becomes overdue bears interest at a rate equal to 2.0% per annum in excess of the rate of interest applicable to base rate loans.

Certain of RAI's subsidiaries, including its Material Subsidiaries, as defined in the Credit Agreement, have guaranteed, on an unsecured basis, RAI's obligations under the Credit Agreement. Under the Credit Agreement, any new Material Subsidiary of RAI must be added as a guarantor of the Credit Agreement.

As of December 31, 2016, there were no outstanding borrowings and $6 million of letters of credit outstanding under the Credit Agreement.

Bridge Facility

In September 2014, RAI entered into a bridge credit agreement, referred to as the Bridge Facility, with a syndicate of lenders, for the purpose of financing a portion of the Lorillard Merger Consideration. RAI issued notes, in lieu of borrowing any funds under the Bridge Facility, to finance part of the cash portion of the Lorillard Merger Consideration. By its terms, the Bridge Facility terminated on June 12, 2015. All associated fees were fully amortized by June 30, 2015. Amortization and fees related to the Bridge Facility were $48 million and $39 million for the years ended December 31, 2015 and 2014, respectively, and were included in interest and debt expense.

Note 12 — Long-Term Debt

Information, including a schedule of maturities, regarding RAI's and RJR Tobacco's long-term debt is provided below:

RAI and RJR Tobacco Long-Term Debt

	For the years ended December 31,	
	2016	2015
RAI		
3.500% notes due 08/04/2016	$ —	$ 415
6.750% notes due 06/15/2017	—	700
2.300% notes due 08/21/2017	447	447
7.750% notes due 06/01/2018	—	250
2.300% notes due 06/12/2018	1,250	1,250
8.125% notes due 06/23/2019*	669	669
6.875% notes due 05/01/2020	641	641
3.250% notes due 06/12/2020	771	1,250
4.000% notes due 06/12/2022	1,000	1,000
3.250% notes due 11/01/2022	158	1,100
3.750% notes due 05/20/2023	30	474
4.850% notes due 09/15/2023	550	550
4.450% notes due 06/12/2025	2,500	2,500
5.700% notes due 08/15/2035	750	750
7.250% notes due 06/15/2037	450	450
8.125% notes due 05/01/2040	237	237
7.000% notes due 08/04/2041	240	240
4.750% notes due 11/01/2042	173	1,000
6.150% notes due 09/15/2043	550	550
5.850% notes due 08/15/2045	2,250	2,250
Total principal	12,666	16,723
Fair value adjustments	282	348
Unamortized discounts	(28)	(37)
Unamortized debt issuance costs	(68)	(92)
Total RAI long-term debt at carrying value	$12,852	$16,942
RJR Tobacco		
3.500% notes due 08/04/2016	$ —	$ 85
2.300% notes due 08/21/2017	53	53
8.125% notes due 06/23/2019*	81	81
6.875% notes due 05/01/2020	109	109
3.750% notes due 05/20/2023	19	26
8.125% notes due 05/01/2040	13	13
7.000% notes due 08/04/2041	9	10
Total principal	284	377
Fair value adjustments	29	36
Total RJR Tobacco long-term debt at carrying value	$ 313	$ 413
Total long-term debt at carrying value	$13,165	$17,355
Less current maturities of long-term debt at carrying value	501	506
Total long-term debt (less current maturities) at carrying value	$12,664	$16,849

* The interest rate payable on these notes generally is subject to adjustment from time to time (as detailed in the form of these notes) based upon the credit rating assigned to these notes, provided that in no event will (1) the interest rate for these notes be reduced below 8.125% or (2) the total increase in the interest rate on these notes exceed 2.0% above 8.125%.

During the year ended December 31, 2016, RJR Tobacco repurchased $8 million of its outstanding notes. As of December 31, 2016, the maturities of RAI's and RJR Tobacco's notes, excluding fair value adjustments and unamortized discounts and debt issuance costs, were as follows:

Year	RAI	RJR Tobacco	Total
2017	$ 447	$ 53	$ 500
2018	1,250	—	1,250
2019	669	81	750
2020	1,412	109	1,521
2022 and thereafter	8,888	41	8,929
	$12,666	$284	$12,950

Fair Value of Debt

The estimated fair value of RAI's outstanding consolidated debt, in the aggregate, was $14.3 billion and $18.2 billion as of December 31, 2016 and 2015, respectively, with an effective annual interest rate of approximately 5.0% and 4.6% for the years ended December 31, 2016 and 2015, respectively. The fair value is derived from a third party pricing source and is classified in Level 2 of the fair value hierarchy.

Termination of Interest Rate Swap Agreements

On June 12, 2015, RJR Tobacco assumed the interest rate swap agreements associated with the 8.125% Lorillard Tobacco Notes due June 23, 2019. The interest rate swap agreements qualified for hedge accounting and were designated as fair value hedges at the date of the Lorillard Merger. Under the swap agreements, RJR Tobacco received a fixed rate settlement and paid a variable rate settlement with the difference recorded in interest expense. During 2016, RJR Tobacco terminated these interest rate swap agreements. The remaining fair value adjustment of $7 million for the 8.125% notes due June 23, 2019, is being amortized as a reduction of interest expense over the expected remaining life of the notes.

See note 2 for additional information on the Lorillard Merger and note 4 for additional information on interest rate management.

Tender Offer and Redemption

RAI completed a cash tender offer for an aggregate purchase price of $2.81 billion (excluding accrued and unpaid interest to, but not including, the settlement date of February 22, 2016, and excluding related fees and expenses), referred to as the Tender Cap, for certain of its outstanding notes listed in the table below, collectively referred to as the Tender Notes.

RAI accepted for purchase $2.69 billion in aggregate principal amount of Tender Notes validly tendered and not validly withdrawn on or prior to 5 p.m., New York City time, on February 18, 2016, referred to as the Early Tender Date. On February 22, 2016, RAI paid, with cash on hand, aggregate consideration of $2.81 billion (including a premium of approximately $118 million, but excluding accrued and unpaid interest) for such Tender Notes accepted for purchase. In addition, RAI recognized $22 million of unamortized discount and unamortized debt issuance costs related to the Tender Notes as a loss on early extinguishment of debt.

RAI accepted for purchase 100% of the Tender Notes validly tendered and not validly withdrawn for the series listed in the table below in acceptance priority levels 1 through 3. Due to oversubscription, RAI accepted for purchase Tender Notes validly tendered and not validly withdrawn for the series listed in the table below in acceptance priority level 4 on a pro rata basis in accordance with the proration procedures described in the tender offer documents. RAI did not accept for purchase any of the Tender Notes for the series listed in the table below in acceptance priority levels 5 through 7.

Title of Security	Acceptance Priority Level	Principal Amount Tendered at Expiration	Principal Amount of Tender Notes Accepted for Purchase	Percentage of Outstanding Tender Notes Purchased
4.750% Senior Notes due 2042	1	$ 827	$ 827	82.71%
3.250% Senior Notes due 2022	2	942	942	85.59%
3.750% Senior Notes due 2023	3	444	444	93.76%
3.250% Senior Notes due 2020(1)	4	1,039	479	38.34%
4.000% Senior Notes due 2022	5	766	—	0.00%
4.450% Senior Notes due 2025	6	1,773	—	0.00%
4.850% Senior Notes due 2023	7	416	—	0.00%

(1) Series Prorated

Since aggregate consideration payable to holders of Tender Notes validly tendered and not validly withdrawn exceeded the Tender Cap on or prior to the Early Tender Date, RAI did not accept for purchase any additional tenders of Tender Notes made after the Early Tender Date.

In May 2012, RAI entered into forward starting interest rate contracts with an aggregate notional amount of $1 billion. RAI designated those derivatives as cash flow hedges of a future debt issuance. In October 2012, RAI completed the sale of notes that had been forecasted, and the 3.250% Tender Notes due 2022 and the 4.750% Tender Notes due 2042 were designated as the hedged instruments under these derivative contracts. The forward starting interest rate contracts were immediately terminated, and the effective portion of the loss incurred was recorded in accumulated other comprehensive loss in the consolidated balance sheets and was amortized over the life of the related debt. The amount of 3.250% Tender Notes due 2022 and the 4.750% Tender Notes due 2042 repurchased in the tender offer exceeded the original notional amount of the forward starting interest rate contracts and, accordingly, the remaining unamortized loss related to the forward starting interest rate contracts of $16 million was recognized as expense upon completion of the tender offer.

The 3.750% Tender Notes due 2023 have a carrying value that exceeds face value as these notes, which were assumed in the Lorillard Tobacco Merger, were recorded at fair value in purchase accounting. Approximately 94% of this fair value adjustment, or $11 million, which represents the proportional amount of Tender Notes repurchased in this series, was recognized as part of the loss on early extinguishment of debt.

Pursuant to its previously announced redemption call, on March 5, 2016, RAI redeemed all $700 million outstanding aggregate principal amount of its 6.750% Senior Notes due 2017 and all $250 million outstanding aggregate principal amount of its 7.750% Senior Notes due 2018. In connection with the redemption, RAI recorded a loss on early extinguishment of debt of $90 million, which consisted of $88 million in make-whole premiums paid to noteholders as part of the redemption and $2 million for unamortized discount and unamortized debt issuance costs related to the redeemed notes.

In 2009, RAI and RJR entered into offsetting floating to fixed interest rate swap agreements with the same financial institution that held certain fixed to floating interest rate swaps for the same notional amount. The swaps were designated as fair value hedges. In September 2011, the original and offsetting interest rate swap agreements were terminated with the carrying value of the hedged debt reflecting a fair value adjustment treated as a premium, at the date of termination. At that point, RAI began amortizing the fair value adjustment. As of December 31, 2015, the $700 million of 6.750% notes due 2017 represented the remaining debt that had been hedged with these interest rate swap agreements. Upon the redemption of these notes, the remaining unamortized fair value adjustment for the terminated swaps of $25 million was recognized and, accordingly, reduced the loss on early extinguishment of debt.

In the aggregate, expenses related to the cash tender offer and redemption of approximately $239 million, which included legal and bank fees of approximately $7 million, were recognized in other (income) expense, net in the consolidated statements of income for the year ended December 31, 2016.

New Notes

On June 12, 2015, RAI completed an underwritten public offering of $9.0 billion aggregate principal amount of its senior notes. The proceeds from this offering were used to fund part of the cash portion of the Lorillard Merger Consideration, the unpaid fees and expenses incurred in connection with the Lorillard Merger and related transactions, and the payment of certain Lorillard equity awards and certain change of control payments, also in connection with the Lorillard Merger.

The notes are unsecured, and are fully and unconditionally guaranteed on a senior unsecured basis by certain of RAI's subsidiaries, including its material domestic subsidiaries, which are the same guarantors that guarantee its other outstanding senior notes and its Credit Agreement. RAI may redeem the notes in whole or in part at any time at the applicable redemption price. If RAI experiences specific kinds of changes of control, accompanied by a certain credit ratings downgrade of any series of the notes, RAI must offer to repurchase such series.

Lorillard Tobacco Notes; Exchange Offers and Consent Solicitations

Immediately prior to the Lorillard Merger, Lorillard Tobacco had outstanding an aggregate of $3.5 billion in principal amount of senior unsecured notes in seven series, referred to as the Lorillard Tobacco Notes, all of which were guaranteed by Lorillard. In connection with the Lorillard Tobacco Merger, RJR Tobacco assumed

Lorillard Tobacco's obligations under the Lorillard Tobacco Notes and the indenture governing the Lorillard Tobacco Notes, referred to as the Lorillard Tobacco Indenture, and RJR assumed Lorillard's obligations as guarantor under the Lorillard Tobacco Notes and the Lorillard Tobacco Indenture.

On June 11, 2015, RAI commenced (1) private offers to exchange, referred to as the Exchange Offers, any and all (to the extent held by eligible holders) of the Lorillard Tobacco Notes for a series of new RAI senior notes, referred to as the Exchange Notes, having the same interest payment and maturity dates and interest rate provisions as the corresponding series of Lorillard Tobacco Notes, and (2) related consent solicitations, referred to as the Consent Solicitations, of the eligible holders of each series of Lorillard Tobacco Notes to amend the Lorillard Tobacco Indenture, with such amendments referred to as the Indenture Amendments. Eligible holders who validly tendered, and did not validly withdraw, their Lorillard Tobacco Notes in the Exchange Offers (and thereby gave, and did not validly revoke, their consents to the Indenture Amendments) received, upon settlement of the Exchange Offers and Consent Solicitations on July 15, 2015, Exchange Notes in the same principal amount as the Lorillard Tobacco Notes tendered therefor plus a consent payment of $2.50 per $1,000 principal amount of Lorillard Tobacco Notes tendered. Lorillard Tobacco Notes in the aggregate principal amount of $3.1 billion were tendered in the Exchange Offers.

RJR Tobacco is the principal obligor of the Lorillard Tobacco Notes that were not tendered in the Exchange Offers and that remain outstanding, and currently RAI and RJR are the guarantors of such notes. The Exchange Notes are the principal obligations of RAI and are guaranteed by the same guarantors as RAI's other outstanding senior notes. Unlike RAI's outstanding senior notes, the Lorillard Tobacco Notes (with a limited exception for the 3.75% Lorillard Tobacco Notes due 2023) are not redeemable at the option of the issuer prior to maturity.

The Exchange Notes were issued in a private offering exempt from, or not subject to, the registration requirements of the Securities Act of 1933, referred to as the 1933 Act. Pursuant to a registration rights agreement it had entered into, RAI subsequently conducted, in 2015, registered offers to exchange any and all (to the extent held by eligible holders) of the Exchange Notes for its newly issued notes registered under the 1933 Act, referred to as the Registered Notes. Of the total aggregate principal amount of Exchange Notes outstanding, 99.7% were exchanged for Registered Notes in the registered exchange offers. Each series of Registered Notes is substantially identical to the Exchange Notes of the corresponding series, except that, among other things, certain additional interest provisions pertaining to the Exchange Notes do not apply to the Registered Notes. The Registered Notes are unsecured, and are fully and unconditionally guaranteed on a senior unsecured basis by the same RAI subsidiaries that guarantee RAI's other outstanding senior notes and its Credit Agreement. Any guarantor that is released from its guarantee under the Credit Agreement, or any replacement or refinancing thereof, also will be released automatically from its guarantee of the Registered Notes and RAI's other outstanding notes. RAI may redeem the Registered Notes, in whole or in part, at any time at the applicable redemption price. If RAI experiences specific kinds of change of control, accompanied by a certain credit rating downgrade of any series of Registered Notes, RAI must offer to repurchase such series.

In addition, in connection with the Consent Solicitations, RAI received the requisite number of consents to adopt the Indenture Amendments, which became operative on the July 15, 2015, settlement date, with respect to each of the seven series of Lorillard Tobacco Notes. The Indenture Amendments:

- eliminated substantially all of the restrictive covenants and a bankruptcy event of default for the issuer and the guarantor of the Lorillard Tobacco Notes under the Lorillard Tobacco Indenture;
- eliminated the requirement under the Lorillard Tobacco Indenture that the guarantor of the Lorillard Tobacco Notes continue to provide holders of the Lorillard Tobacco Notes with financial statements and other financial information similar to that provided in periodic reports under the Securities Exchange Act of 1934 when it is not subject to such reporting requirements; and
- relieved the issuer of the Lorillard Tobacco Notes of the requirement (if any) under the Lorillard Tobacco Indenture that the issuer offer to repurchase the Lorillard Tobacco Notes upon certain change of control events combined with certain credit ratings events to the extent such change of control events relate to, arise out of or are undertaken in connection with the Lorillard Merger or the Lorillard Tobacco Merger.

Note 13 — Commitments and Contingencies

Tobacco Litigation — General

Introduction

Litigation, claims, and other legal proceedings relating to the use of, exposure to, or purchase of tobacco products are pending or may be instituted in the future against RJR Tobacco (including as successor by merger to Lorillard Tobacco), American Snuff Co., SFNTC, RJR Vapor, RAI, Lorillard, other RAI affiliates, and indemnitees (including but not limited to B&W), sometimes referred to collectively as Reynolds Defendants. These pending legal proceedings include claims relating to cigarette products manufactured by RJR Tobacco, Lorillard Tobacco, SFNTC or certain of their affiliates or indemnitees, smokeless tobacco products manufactured by American Snuff Co., and e-cigarette products manufactured on behalf of and marketed by RJR Vapor. A discussion of the legal proceedings relating to cigarette products (and e-cigarettes) is set forth below under the heading "— Litigation Affecting the Cigarette Industry." All of the references under that heading to tobacco-related litigation, smoking and health litigation and other similar references are references to legal proceedings relating to cigarette products or e-cigarettes, as the case may be, and are not references to legal proceedings involving smokeless tobacco products, and case numbers under that heading include only cases involving cigarette products and e-cigarettes. The legal proceedings relating to the smokeless tobacco products manufactured by American Snuff Co. are discussed separately under the heading "— Smokeless Tobacco Litigation" below.

In connection with the B&W business combination, RJR Tobacco undertook certain indemnification obligations with respect to B&W and its affiliates, including its indirect parent, BAT. See "— Litigation Affecting the Cigarette Industry — Overview — Introduction" below. In connection with the Lorillard Merger and Divestiture, as applicable, RAI and RJR Tobacco undertook certain indemnification obligations. See "— Litigation Affecting the Cigarette Industry — Overview — Introduction," "— Other Contingencies — ITG Indemnity," and "— Other Contingencies — Loews Indemnity" below. In addition, in connection with the sale of the non-U.S. operations and business of the NATURAL AMERICAN SPIRIT brand, the Sellers have agreed to indemnify the buyer for certain claims. See "— Other Contingencies — JTI Indemnities" below.

Certain Terms and Phrases

Certain terms and phrases used in this footnote may require some explanation. The term "judgment" or "final judgment" refers to the final decision of the court resolving the dispute and determining the rights and obligations of the parties. At the trial court level, for example, a final judgment generally is entered by the court after a jury verdict and after post-verdict motions have been decided. In most cases, the losing party can appeal a verdict only after a final judgment has been entered by the trial court.

The term "damages" refers to the amount of money sought by a plaintiff in a complaint, or awarded to a party by a jury or, in some cases, by a judge. "Compensatory damages" are awarded to compensate the prevailing party for actual losses suffered, if liability is proved. In cases in which there is a finding that a defendant has acted willfully, maliciously or fraudulently, generally based on a higher burden of proof than is required for a finding of liability for compensatory damages, a plaintiff also may be awarded "punitive damages." Although damages may be awarded at the trial court stage, a losing party generally may be protected from paying any damages until all appellate avenues have been exhausted by posting a supersedeas bond. The amount of such a bond is governed by the law of the relevant jurisdiction and generally is set at the amount of damages plus some measure of statutory interest, modified at the discretion of the appropriate court or subject to limits set by a court or statute.

The term "*per curiam*" refers to a decision entered by an appellate court that is not signed by an individual judge. In most cases, it is used to indicate that the opinion entered is a brief announcement of the court's decision and is not accompanied by an opinion explaining the court's reasoning.

The term "settlement" refers to certain types of cases in which cigarette manufacturers, including RJR Tobacco, B&W and Lorillard Tobacco, have agreed to resolve disputes with certain plaintiffs without resolving the cases through trial. The principal terms of certain settlements entered into by RJR Tobacco, B&W and Lorillard Tobacco are explained below under "— Accounting for Tobacco-Related Litigation Contingencies."

Theories of Recovery

The plaintiffs seek recovery on a variety of legal theories, including negligence, strict liability in tort, design defect, failure to warn, fraud, misrepresentation, violations of unfair and deceptive trade practices statutes,

conspiracy, medical monitoring and violations of state and federal antitrust laws. In certain of these cases, the plaintiffs claim that cigarette smoking exacerbated injuries caused by exposure to asbestos or, in the case of certain claims asserted against Lorillard Tobacco, that they were injured by exposure to filters containing asbestos used in one cigarette brand for roughly four years before 1957, the latter cases referred to as Filter Cases.

The plaintiffs seek various forms of relief, including compensatory and, where available, punitive damages, treble or multiple damages and statutory damages and penalties, creation of medical monitoring and smoking cessation funds, disgorgement of profits, and injunctive and other equitable relief. Although alleged damages often are not determinable from a complaint, and the law governing the pleading and calculation of damages varies from jurisdiction to jurisdiction, compensatory and punitive damages have been specifically pleaded in a number of cases, sometimes in amounts ranging into the hundreds of millions and even billions of dollars.

Defenses

The defenses raised by Reynolds Defendants include, where applicable and otherwise appropriate, preemption by the Federal Cigarette Labeling and Advertising Act of some or all claims arising after 1969, or by the Comprehensive Smokeless Tobacco Health Education Act for claims arising after 1986, the lack of any defect in the product, assumption of the risk, contributory or comparative fault, lack of proximate cause, remoteness, lack of standing, statutes of limitations or repose and others. RAI, RJR and Lorillard have asserted additional defenses, including jurisdictional defenses, in many of the cases in which they are named.

Accounting for Tobacco-Related Litigation Contingencies

In accordance with GAAP, RAI and its subsidiaries record any loss concerning litigation at such time as an unfavorable outcome becomes probable and the amount can be reasonably estimated on an individual case-by-case basis. For the reasons set forth below, RAI's management continues to conclude that the loss of any particular pending tobacco-related litigation claim against the Reynolds Defendants, when viewed on an individual basis, is not probable, except for certain *Engle* Progeny cases noted below.

Reynolds Defendants believe that they have valid defenses to the tobacco-related litigation claims against them, as well as valid bases for appeal of adverse verdicts against them. Reynolds Defendants have, through their counsel, filed pleadings and memoranda in pending tobacco-related litigation that set forth and discuss a number of grounds and defenses that they and their counsel believe have a valid basis in law and fact. With the exception of the *Engle* Progeny cases described below, Reynolds Defendants continue to win the majority of tobacco-related litigation claims that reach trial, and a very high percentage of the tobacco-related litigation claims brought against them, including *Engle* Progeny cases, continue to be dismissed at or before trial. Based on their experience in tobacco-related litigation and the strength of the defenses available to them in such litigation, Reynolds Defendants believe that their successful defense of tobacco-related litigation in the past will continue in the future.

RAI's consolidated balance sheet as of December 31, 2016, contains accruals for the following *Engle* Progeny cases: *Starr-Blundell*, *Buonomo,* and *Ward* (for attorneys' fees and interest only). In the fourth quarter of 2016, RJR Tobacco paid approximately $17 million in satisfaction of the judgment, including attorneys' fees and interest, in *Wilcox*. Other accruals include an amount for the estimated costs of the corrective communications in the *U.S. Department of Justice* case. As other cases proceed through the appellate process, RAI will evaluate the need for further accruals on an individual case-by-case basis if an unfavorable outcome becomes probable and the amount can be reasonably estimated.

It is the policy of Reynolds Defendants to defend tobacco-related litigation claims vigorously; generally, Reynolds Defendants and indemnitees do not settle such claims. However, Reynolds Defendants may enter into settlement discussions in some cases, if they believe it is in their best interests to do so. Exceptions to this general approach include, but are not limited to, actions taken pursuant to "offer of judgment" statutes, as described below in "— Litigation Affecting the Cigarette Industry — Overview," and Filter Cases, as described below in "— Litigation Affecting the Cigarette Industry — Filter Cases," as well as other historical examples discussed below.

With respect to smoking and health tobacco litigation claims, the only significant settlements reached by RJR Tobacco, Lorillard Tobacco and B&W involved:

- the State Settlement Agreements and the funding by various tobacco companies of a $5.2 billion trust fund contemplated by the MSA to benefit tobacco growers;

- the original *Broin* flight attendant case discussed below under "— Litigation Affecting the Cigarette Industry — *Broin II* Cases," and
- most of the *Engle* Progeny cases pending in federal court, after the initial docket of over 4,000 such cases was reduced to approximately 400 cases.

The circumstances surrounding the State Settlement Agreements and the funding of a trust fund to benefit the tobacco growers are readily distinguishable from the current categories of tobacco-related litigation claims involving Reynolds Defendants. In the claims underlying the State Settlement Agreements, the states sought to recover funds paid for health care and medical and other assistance to state citizens suffering from diseases and conditions allegedly related to tobacco use. The State Settlement Agreements settled all the health-care cost recovery actions brought by, or on behalf of, the settling jurisdictions and contain releases of various additional present and future claims. In accordance with the MSA, various tobacco companies agreed to fund a $5.2 billion trust fund to be used to address the possible adverse economic impact of the MSA on tobacco growers. A discussion of the State Settlement Agreements, and a table depicting the related payment schedule, is set forth below under "— Litigation Affecting the Cigarette Industry — Health-Care Cost Recovery Cases."

As with claims that were resolved by the State Settlement Agreements, the other cases settled by RJR Tobacco can be distinguished from existing cases pending against the Reynolds Defendants. The original *Broin* case, discussed below under "— Litigation Affecting the Cigarette Industry — *Broin II* Cases," was settled in the middle of trial during negotiations concerning a possible nation-wide settlement of claims similar to those underlying the State Settlement Agreements.

The federal *Engle* Progeny cases likewise presented exceptional circumstances not present in the state *Engle* Progeny cases or elsewhere. All of the federal *Engle* Progeny cases subject to the settlement were pending in the same court, were coordinated by the same judge, and involved the same sets of plaintiffs' lawyers. Moreover, RJR Tobacco settled only after approximately 90% of the federal *Engle* Progeny cases otherwise had been resolved. A discussion of the *Engle* Progeny cases and the settlement of the federal *Engle* Progeny cases is set forth below under "— Litigation Affecting the Cigarette Industry — *Engle* and *Engle* Progeny Cases."

In 2010, RJR Tobacco entered into a comprehensive agreement with the Canadian federal, provincial and territorial governments, which resolved all civil claims related to the movement of contraband tobacco products in Canada during the period 1985 through 1999 that the Canadian governments could assert against RJR Tobacco and its affiliates. These claims involved different theories of recovery than the other tobacco-related litigation claims pending against the Reynolds Defendants.

Also, in 2004, RJR Tobacco and B&W separately settled the antitrust case *DeLoach v. Philip Morris Cos., Inc.,* which was brought by a unique class of plaintiffs: a class of all tobacco growers and tobacco allotment holders. The plaintiffs asserted that the defendants conspired to fix the price of tobacco leaf and to destroy the federal government's tobacco quota and price support program. Despite legal defenses they believed to be valid, RJR Tobacco and B&W separately settled this case to avoid a long and contentious trial with the tobacco growers. The *DeLoach* case involved different types of plaintiffs and different theories of recovery under the antitrust laws than the other tobacco-related litigation claims pending against the Reynolds Defendants.

Finally, as discussed under "— Litigation Affecting the Cigarette Industry — State Settlement Agreements—Enforcement and Validity; Adjustments," RJR Tobacco, B&W and Lorillard Tobacco each has settled certain cases brought by states concerning the enforcement of State Settlement Agreements. Despite legal defenses believed to be valid, these cases were settled to avoid further contentious litigation with the states involved. These enforcement actions involved alleged breaches of State Settlement Agreements based on specific actions taken by particular defendants. Accordingly, any future enforcement actions involving State Settlement Agreements will be reviewed by RJR Tobacco on the merits and should not be affected by the settlement of prior enforcement cases.

Cautionary Statement

Even though RAI's management continues to believe that the loss of particular pending tobacco-related litigation claims against Reynolds Defendants, when viewed on an individual case-by-case basis, is not probable or estimable (except for certain *Engle* Progeny and Filter cases described below), the possibility of material losses related to such litigation is more than remote. Litigation is subject to many uncertainties, and generally, it is not possible to predict the outcome of any particular litigation pending against Reynolds Defendants, or to reasonably estimate the amount or range of any possible loss.

Although Reynolds Defendants believe that they have valid bases for appeals of adverse verdicts in their pending cases and valid defenses to all actions and intend to defend them vigorously as described above, it is possible that there could be further adverse developments in pending cases, and that additional cases could be decided unfavorably against Reynolds Defendants. Determinations of liability or adverse rulings in such cases or in similar cases involving other cigarette manufacturers as defendants, even if such judgments are not final, could have a material adverse effect on the litigation against Reynolds Defendants and could encourage the commencement of additional tobacco-related litigation. Reynolds Defendants also may enter into settlement discussions in some cases, if they believe it is in their best interests to do so. In addition, a number of political, legislative, regulatory and other developments relating to the tobacco industry and cigarette smoking have received wide media attention. These developments may negatively affect the outcomes of tobacco-related legal actions and encourage the commencement of additional similar litigation.

Although it is impossible to predict the outcome of such events on pending litigation and the rate new lawsuits may be filed against Reynolds Defendants, a significant increase in litigation or in adverse outcomes for tobacco defendants, or difficulties in obtaining the bonding required to stay execution of judgments on appeal, could have a material adverse effect on any or all of these entities. Moreover, notwithstanding the quality of defenses available to Reynolds Defendants in litigation matters, it is possible that RAI's results of operations, cash flows or financial position could be materially adversely affected by the ultimate outcome of certain pending litigation or future claims against Reynolds Defendants.

Litigation Affecting the Cigarette Industry

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Overview

Introduction. In connection with the B&W business combination, RJR Tobacco agreed to indemnify B&W and its affiliates against, among other things, certain litigation liabilities, costs and expenses incurred by B&W or its affiliates arising out of the U.S. cigarette and tobacco business of B&W. Also, as a result of the Lorillard Tobacco Merger, Lorillard Tobacco was merged into RJR Tobacco with RJR Tobacco being the surviving entity, Lorillard Tobacco ceasing to exist, and RJR Tobacco succeeding to Lorillard Tobacco's liabilities, including Lorillard Tobacco's litigation liabilities, costs and expenses. Although Lorillard Tobacco no longer exists as a result of the Lorillard Tobacco Merger, it will remain as a named party in cases pending on the date of the Lorillard Tobacco Merger until courts grant motions to substitute RJR Tobacco for Lorillard Tobacco or the claims are dismissed. The cases discussed below include cases brought against RJR Tobacco, Lorillard Tobacco and their affiliates and indemnitees, including RAI, RJR, B&W and Lorillard. Cases brought against SFNTC and RJR Vapor also are discussed.

During the fourth quarter of 2016, 23 tobacco-related cases were served against Reynolds Defendants. On December 31, 2016, there were, subject to the exclusions described immediately below, 304 cases pending against Reynolds Defendants: 287 in the United States and 17 in Canada, as compared with 268 total cases on December 31, 2015. Of the U.S. cases pending on December 31, 2016, 34 are pending in federal court, 252 in state court and one in tribal court, primarily in the following states: Illinois (52 cases); Maryland (52 cases); Florida (27 cases); New York (21 cases); Missouri (19 cases); Massachusetts (18 cases); New Mexico (14 cases); and California (12 cases). The U.S. case number excludes the approximately 564 individual smoker cases pending in West Virginia state court as a consolidated action, 2,822 *Engle* Progeny cases, involving approximately 3,645 individual plaintiffs, and 2,406 *Broin II* cases, pending in the United States against RJR Tobacco, Lorillard Tobacco or certain other Reynolds Defendants.

The following table lists the categories of the U.S. tobacco-related cases pending against Reynolds Defendants as of December 31, 2016, and the increase or decrease from the number of cases pending against Reynolds Defendants as of September 30, 2016, as reported in RAI's Quarterly Report on Form 10-Q for the fiscal quarter ended September 30, 2016, filed with the U.S. Securities and Exchange Commission, referred to as the SEC, on October 19, 2016, and a cross-reference to the discussion of each case type.

Case Type	U.S. Case Numbers as of December 31, 2016	Change in Number of Cases Since September 30, 2016 Increase/(Decrease)
Individual Smoking and Health	132	7
West Virginia IPIC (Number of Plaintiffs)*	1 (approx. 564)	No change
Engle Progeny (Number of Plaintiffs)**	2,822 (approx. 3,645)	(66) (110)
Broin II	2,406	(15)
Class Action	25	1
Filter Cases	78	4
Health-Care Cost Recovery	2	No change
State Settlement Agreements—Enforcement and Validity; Adjustments	28	No change
Other Litigation and Developments	21	No change

* Includes as one case the approximately 564 cases pending as a consolidated action *In Re: Tobacco Litigation Individual Personal Injury Cases*, sometimes referred to as *West Virginia IPIC* cases, described below. The *West Virginia IPIC* cases have been separated from the Individual Smoking and Health cases for reporting purposes.

** The *Engle* Progeny cases have been separated from the Individual Smoking and Health cases for reporting purposes. The number of cases will fluctuate as cases are dismissed or if any of the dismissed cases are appealed.

The Florida state court class-action case, *Engle v. R. J. Reynolds Tobacco Co.*, and the related cases commonly referred to as *Engle* Progeny cases have attracted significant attention. After the Florida Supreme Court's 2006 ruling that members of the formerly certified class could file individual actions, roughly 10,000 claims or actions were filed in Florida state or federal courts before the deadline set by the Florida Supreme Court. No new or additional such claims may be filed. As reflected in the table above, 2,822 *Engle* Progeny cases were pending as of December 31, 2016, that included claims asserted on behalf of 3,645 plaintiffs. Following an agreement to settle most *Engle* Progeny cases that remained pending in federal courts in the first quarter of 2015, nearly all *Engle* Progeny cases currently pending are in Florida state courts. Since 2009, there have been over 200 *Engle* Progeny trials in Florida state or federal courts involving RJR Tobacco or Lorillard Tobacco. As described more fully immediately below in "— *Scheduled Trials*" and "— *Trial Results*," additional *Engle* Progeny cases involving RJR Tobacco are being tried and set for trial on an ongoing basis. Juries in *Engle* Progeny cases have awarded substantial amounts in compensatory and punitive damage awards, many of which currently are at various stages in the appellate process. RJR Tobacco and Lorillard Tobacco also have paid substantial amounts in compensatory and punitive damage awards in *Engle* Progeny cases. For a detailed description of these cases, see "— *Engle* and *Engle* Progeny cases" below.

In November 1998, the major U.S. cigarette manufacturers, including RJR Tobacco, B&W and Lorillard Tobacco, entered into the MSA with 46 U.S. states, Washington, D.C. and certain U.S. territories and possessions. These cigarette manufacturers previously settled four other cases, brought on behalf of Mississippi, Florida, Texas and Minnesota, by separate agreements with each state. These State Settlement Agreements:

- settled all health-care cost recovery actions brought by, or on behalf of, the settling jurisdictions;
- released the major U.S. cigarette manufacturers from various additional present and potential future claims;
- imposed future payment obligations in perpetuity on RJR Tobacco, B&W, Lorillard Tobacco and other major U.S. cigarette manufacturers; and
- placed significant restrictions on their ability to market and sell cigarettes and smokeless tobacco products.

Payments under the State Settlement Agreements are subject to various adjustments for, among other things, the volume of cigarettes sold, relative market share, operating profit and inflation. See "— Health-Care Cost

Recovery Cases — State Settlement Agreements" below for a detailed discussion of the State Settlement Agreements, including RAI's operating subsidiaries' monetary obligations under these agreements. RJR Tobacco records the allocation of settlement charges as products are shipped.

Scheduled Trials. Trial schedules are subject to change, and many cases are dismissed before trial. There are 49 cases, exclusive of *Engle* Progeny cases, scheduled for trial as of December 31, 2016 through December 31, 2017, for RJR Tobacco, B&W, Lorillard Tobacco or their affiliates and indemnitees: six individual smoking and health cases, 34 Filter Cases, five *Broin II* cases and four other non-smoking and health cases. There are also approximately 115 *Engle* Progeny cases against RJR Tobacco, B&W and/or Lorillard Tobacco set for trial through December 31, 2017. It is not known how many of these cases will actually be tried.

Trial Results. From January 1, 2014 through December 31, 2016, 124 individual smoking and health, *Engle* Progeny, Filter and health-care cost recovery cases in which RJR Tobacco, B&W and/or Lorillard Tobacco were defendants were tried, including nine trials for cases where mistrials were declared in the original proceedings. Verdicts in favor of RJR Tobacco, B&W and Lorillard Tobacco and, in some cases, other defendants, were returned in 60 cases, tried in Florida (39), California (1) and New Jersey (1). There were also 19 mistrials in Florida. Verdicts in favor of the plaintiffs were returned in 57 cases tried in Florida, and one in California. Four cases in Florida were dismissed during trial. One case in Florida was a retrial only as to the amount of damages. In another case in Florida, the jury entered a partial verdict that did not include compensatory or punitive damages, and post-trial motions are pending.

In the fourth quarter of 2016, 11 *Engle* Progeny cases in which RJR Tobacco and/or Lorillard Tobacco was a defendant were tried:

- In *Wallace v. R. J. Reynolds Tobacco Co.*, the court declared a mistrial due to weather delays and juror unavailability.
- In *Konzelman v. R. J. Reynolds Tobacco Co.*, the jury returned a verdict in favor of the plaintiff, found the decedent 15% at fault and RJR Tobacco 85% at fault, and awarded approximately $8.8 million in compensatory damages and $20 million in punitive damages.
- In *Maloney v. R. J. Reynolds Tobacco Co.*, the court declared a mistrial due to the jury's inability to reach a unanimous verdict.
- In *Johnston v. R. J. Reynolds Tobacco Co.*, the jury returned a verdict in favor of the plaintiff, found the decedent 10% at fault and RJR Tobacco 90% at fault, and awarded $7.5 million in compensatory damages and $14 million in punitive damages.
- In *Ledo v. R. J. Reynolds Tobacco Co.*, the jury returned a verdict in favor of the plaintiff, found the decedent 51% at fault and RJR Tobacco 49% at fault, and awarded $6 million in compensatory damages.
- In *Howles v. R. J. Reynolds Tobacco Co.*, the jury returned a verdict in favor of the plaintiff, found RJR Tobacco 50% at fault and the remaining defendant 50% at fault, and awarded $4 million in compensatory damages and, against each defendant, $3 million in punitive damages.
- In *Kloppenburg v. R. J. Reynolds Tobacco Co.*, the jury returned a verdict in favor of RJR Tobacco.
- In *Ford v. R. J. Reynolds Tobacco Co.*, the jury returned a verdict in favor of the plaintiff, found the plaintiff 85% at fault and RJR Tobacco 15% at fault, and awarded approximately $1.02 million in compensatory damages. Punitive damages were not awarded.
- In *Stanley Martin v. R. J. Reynolds Tobacco Co.*, the jury returned a verdict in favor of the plaintiff, found the decedent 32% at fault, RJR Tobacco 22% at fault and the remaining defendant 46% at fault, and awarded approximately $5.41 million in compensatory damages and $200,000 in punitive damages against RJR Tobacco and $450,000 in punitive damages against the remaining defendant.
- In *Dubinsky v. R. J. Reynolds Tobacco Co.*, the jury returned a verdict in favor of the defendants, including RJR Tobacco.
- In *Pardue v. R. J. Reynolds Tobacco Co.*, the jury returned a verdict in favor of the plaintiff, found the decedent 25% at fault, RJR Tobacco 50% at fault, and the remaining defendant 25% at fault, and awarded approximately $5.9 million in compensatory damages and, against each defendant, $6.75 million in punitive damages.

For a detailed description of the above-described cases, see "— *Engle* and *Engle* Progeny Cases" below.

In the fourth quarter of 2016, no non- *Engle* Progeny individual smoking and health cases, in which RJR Tobacco, B&W and/or Lorillard Tobacco was a defendant, were tried.

In the fourth quarter of 2016, no Filter cases, in which RJR Tobacco and/or Lorillard Tobacco was a defendant, were tried.

For information on the verdicts in the *Engle* Progeny cases that have been tried and remain pending as of December 31, 2016, in which verdicts have been returned against RJR Tobacco, Lorillard Tobacco or B&W, or all three, see the *Engle* Progeny cases charts at "— *Engle* and *Engle* Progeny Cases" below. The following chart reflects the verdicts in the non- *Engle* Progeny smoking and health cases, health-care cost recovery cases or Filter Cases that have been tried and remain pending as of December 31, 2016, in which verdicts have been returned against RJR Tobacco, B&W or Lorillard Tobacco, or all three.

Date of Verdict	Case Name/Type	Jurisdiction	Verdict
August 17, 2006	*United States v. Philip Morris USA, Inc.* [Governmental Health-Care Cost Recovery]	U.S. District Court, District of Columbia, (Washington, D.C.)	RJR Tobacco, B&W and Lorillard Tobacco were found liable for civil RICO claims; were enjoined from using certain brand descriptors and from making certain misrepresentations; and were ordered to make corrective communications on five subjects, including smoking and health and addiction, to reimburse the U.S. Department of Justice appropriate costs associated with the lawsuit, and to maintain document web sites.
May 26, 2010	*Izzarelli v. R. J. Reynolds Tobacco Co.* [Individual]	U.S. District Court, District of Connecticut, (Bridgeport, CT)	$13.76 million in compensatory damages; 58% of fault assigned to RJR Tobacco, which reduced the award to $7.98 million against RJR Tobacco; $3.97 million in punitive damages.
September 13, 2013	*DeLisle v. A. W. Chesterton Co.* [Filter]	Circuit Court, Broward County, (Ft. Lauderdale, FL)	$8 million in compensatory damages; 44% of fault assigned to Lorillard Tobacco, which reduced the award to $3.52 million against Lorillard Tobacco.
July 30, 2014	*Major v. Lorillard Tobacco Co.* [Individual]	Superior Court, Los Angeles County, (Los Angeles, CA)	$17.74 million in compensatory damages; 17% of fault assigned to Lorillard Tobacco, which reduced the award to $3.78 million against Lorillard Tobacco.
July 8, 2015	*Larkin v. R. J. Reynolds Tobacco Co.* [Individual]	Circuit Court, Miami-Dade County, (Miami, FL)	$4.96 million in compensatory damages; 62% of fault assigned to RJR Tobacco; $8.5 million in punitive damages. Comparative fault did not apply to the final judgment.

For information on the post-trial status of individual smoking and health cases, the governmental health-care cost recovery case and the Filter Cases, see "— Individual Smoking and Health Cases," "— Health-Care Cost Recovery Cases — U.S. Department of Justice Case," and "— Filter Cases," respectively, below.

Individual Smoking and Health Cases

As of December 31, 2016, 132 individual cases were pending in the United States against RJR Tobacco, B&W (as RJR Tobacco's indemnitee), Lorillard Tobacco or all three. This category of cases includes smoking and health cases alleging personal injuries caused by tobacco use or exposure brought by or on behalf of individual plaintiffs based on theories of negligence, strict liability, breach of express or implied warranty, and violations of state deceptive trade practices or consumer protection statutes. The plaintiffs seek to recover compensatory damages, attorneys' fees and costs, and punitive damages. The category does not include the *Broin II, Engle* Progeny, Filter Cases or *West Virginia IPIC* cases discussed below. One of the individual cases is brought by or on behalf of an individual or his/her survivors alleging personal injury as a result of exposure to environmental tobacco smoke, referred to as ETS.

Below is a description of the non- *Engle* Progeny individual smoking and health cases against RJR Tobacco, B&W, and/or Lorillard Tobacco that went to trial or were decided during the period from January 1, 2016 to December 31, 2016, or remained on appeal as of December 31, 2016.

On May 26, 2010, in *Izzarelli v. R. J. Reynolds Tobacco Co*. (U.S.D.C. D. Conn., filed 1999), the jury awarded the plaintiff $13.76 million in compensatory damages on the negligence and strict liability claims, found RJR Tobacco 58% at fault and the plaintiff 42% at fault, and found that the plaintiff was entitled to punitive damages. The plaintiff sought to recover damages for personal injuries allegedly sustained as a result of unsafe and unreasonably dangerous cigarette products and for economic losses she sustained as a result of supposed unfair trade practices. On December 5, 2010, the district court (1) awarded the plaintiff $3.97 million in punitive damages, (2) entered a judgment of $11.95 million, and (3) granted the plaintiff $15.8 million in offer of judgment interest through that date and, going forward, approximately $4,000 per day until entry of an amended judgment. In March 2011, the district court entered an amended judgment of approximately $28.1 million. RJR Tobacco appealed to the U.S. Court of Appeals for the Second Circuit, referred to as the Second Circuit, and the plaintiff cross appealed. In September 2013, the Second Circuit certified a question of Connecticut law to the Connecticut Supreme Court, which was answered on April 26, 2016. On July 7, 2016, the Second Circuit ordered another round of briefing to be submitted in the *Izzarelli* appeal after the Connecticut Supreme Court answered certified questions of Connecticut law in the *Bifolck v. Philip Morris, Inc* case. In a decision released on December 29, 2016, the Connecticut Supreme Court answered the questions in *Bifolck*. Briefing in *Izzarelli* will be completed on February 10, 2017.

On July 30, 2014, in *Major v. Lorillard Tobacco Co.* (Super. Ct. Los Angeles County, Cal., filed 2011), the jury awarded the plaintiff approximately $17.74 million in compensatory damages on the negligence and strict liability claims and found the plaintiff 50% at fault, Lorillard Tobacco 17% at fault, and RJR Tobacco and another manufacturer collectively 33% at fault. Punitive damages were not at issue. RJR Tobacco and the other manufacturer had been dismissed prior to trial. The plaintiffs alleged that as a result of the use of the defendants' products and exposure to asbestos, the decedent, William Major, suffered from lung cancer, and sought an unspecified amount of damages. In August 2014, the trial court entered an initial final judgment of approximately $3.9 million against Lorillard Tobacco. On July 1, 2015, the trial court entered an amended final judgment in the amount of approximately $3.78 million in compensatory damages, approximately $135,000 in costs, approximately $1.9 million in prejudgment interest, and post-judgment interest from August 25, 2014 in the amount of approximately $1,100 per day. Lorillard Tobacco appealed from the original and amended judgments, which appeals have been consolidated, and posted a supersedeas bond in the amount of approximately $9.1 million. On October 20, 2015, the appellate court granted RJR Tobacco's motion to substitute itself for Lorillard Tobacco. Briefing is underway.

On July 8, 2015, in *Larkin v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Miami-Dade County, Fla., filed 2002) the jury awarded the plaintiff approximately $4.96 million in compensatory damages on the strict liability and intentional tort claims, found RJR Tobacco 62% at fault and the decedent 38% at fault, and awarded $8.5 million in punitive damages. The plaintiff alleged that as a result of using the defendant's products, the decedent suffered from mouth and lung cancer, and sought an unspecified amount of compensatory and punitive damages. In July 2015, the trial court entered judgment in the amount of approximately $13.46 million. On March 22, 2016, the trial court granted RJR Tobacco's motion for a new trial on claims of defective product and damages only and denied the remaining post-trial motions. The new trial has not been scheduled. In April 2016, RJR Tobacco appealed to the Third District Court of Appeal, referred to as DCA, and the plaintiff cross appealed. Briefing is underway.

On February 8, 2016, in *Pooshs v. Philip Morris USA, Inc.* (U.S.D.C. N.D. Cal., filed 2004) the jury returned a verdict in favor of the defendants, including RJR Tobacco. The plaintiff alleged that as a result of using the defendants' products, the plaintiff suffers from lung cancer. Final judgment was entered on February 9, 2016. The plaintiff filed a notice of appeal to the U.S. Court of Appeals for the Ninth Circuit on March 9, 2016. The case has been stayed through March 27, 2017, pending a decision in *Major*, described above.

West Virginia IPIC

In re: Tobacco Litigation Individual Personal Injury Cases (Cir. Ct. Ohio County, W. Va., filed beginning in 1999), is a series of roughly 1,200 individual cases asserting claims against Philip Morris USA Inc., Lorillard Tobacco, RJR Tobacco, B&W and The American Tobacco Company based on alleged personal injuries. The cases were consolidated for a Phase I trial on various defense conduct issues, to be followed in Phase II by individual trials of remaining claims. On May 15, 2013, the Phase I jury found that defendants' cigarettes were not defectively designed; defendants' cigarettes were not defective due to a failure to warn before July 1, 1969; defendants were not negligent, did not breach warranties, and did not engage in conduct warranting punitive damages; and defendants' ventilated filter cigarettes manufactured and sold between 1964 and July 1, 1969 were defective for a failure to instruct. In November 2014, the West Virginia Supreme Court affirmed the verdict. On June 8, 2015, the U.S. Supreme Court denied the plaintiffs' petition for writ of certiorari. On the same date, the

trial court issued an order finding that only 30 plaintiffs are alleged to have smoked ventilated filter cigarettes in the relevant period. On October 9, 2015, the trial court outlined the procedures for resolving the claims of the 30 Phase II plaintiffs, which claims will focus on whether plaintiffs blocked cigarette vents and, if so, whether blocking proximately caused their alleged injuries. Five cases were selected to be the first claims tried, and they were tentatively scheduled to be tried beginning on May 1, 2017. In June 2016, the court granted the defendants' motion to compel and required the plaintiffs to file additional expert disclosures necessary to attempt to proceed with their claims. The court will set a revised discovery and trial schedule after the expert disclosures are tested for admissibility, and it pushed the tentative trial date to May 2018.

In addition to the foregoing claims, various plaintiffs in 1999 and 2000 asserted claims against retailers and distributors. Those claims were severed and stayed pending the outcome of Phase I. Also, 41 plaintiffs asserted smokeless tobacco claims against various smokeless manufacturers, including 14 claims against certain Reynolds Defendants. Those claims were severed from *IPIC* in 2001, and the plaintiffs took no action to prosecute the claims. They now seek to activate their smokeless claims. On January 25, 2017, the trial court denied the defendants' motion to dismiss those claims as abandoned. The plaintiffs are now free to move forward with their claims.

Engle and Engle Progeny Cases

In July 1998, trial began in *Engle v. R. J. Reynolds Tobacco Co.,* a then-certified class action filed in Circuit Court, Miami-Dade County, Florida*,* against U.S. cigarette manufacturers, including RJR Tobacco, B&W, Lorillard Tobacco, Philip Morris USA Inc., and others. The then-certified class consisted of Florida citizens and residents, and their survivors, who suffered from smoking-related diseases that first manifested between May 5, 1990, and November 21, 1996, and were caused by an addiction to cigarettes. In July 1999, the jury in Phase I found against RJR Tobacco, B&W, Lorillard Tobacco and the other defendants on common issues relating to the defendants' conduct, general causation, the addictiveness of cigarettes, and entitlement to punitive damages.

On July 14, 2000, the jury in Phase II awarded the class a total of approximately $145 billion in punitive damages, which were apportioned $36.3 billion to RJR Tobacco, $17.6 billion to B&W, and $16.3 billion to Lorillard Tobacco. The defendants appealed.

On December 21, 2006, the Florida Supreme Court prospectively decertified the class and set aside the jury's Phase II punitive damages award. But the court preserved certain of the jury's Phase I findings, including that cigarettes can cause certain diseases, nicotine is addictive, and defendants placed defective cigarettes on the market, breached duties of care, concealed health-related information, and conspired. The court also authorized former class members to file individual lawsuits within one year, and it stated that the preserved findings would have *res judicata* effect in those actions.

In the year after the Florida Supreme Court's *Engle* decision, putative class members filed thousands of individual actions against RJR Tobacco, B&W, Lorillard Tobacco, Philip Morris USA Inc., and the other *Engle* defendants, which actions commonly are referred to as *Engle* Progeny cases. As of December 31, 2016, 2,809 *Engle* Progeny cases were pending in state courts, and 13 *Engle* Progeny cases were pending in federal court against RJR Tobacco, B&W and/or Lorillard Tobacco. Those cases include claims by or on behalf of approximately 3,645 plaintiffs. As of December 31, 2016, RJR Tobacco also was aware of nine additional *Engle* Progeny cases that have been filed but not served. The number of pending cases fluctuates for a variety of reasons, including voluntary and involuntary dismissals. Voluntary dismissals include cases in which a plaintiff accepts an "offer of judgment," referred to in Florida statutes as "proposals for settlement," from RJR Tobacco, Lorillard Tobacco and/or RJR Tobacco's affiliates and indemnitees. An offer of judgment, if rejected by the plaintiff, preserves RJR Tobacco's and Lorillard Tobacco's right to recover attorneys' fees under Florida law in the event of a verdict favorable to RJR Tobacco or Lorillard Tobacco. Such offers are sometimes made through court-ordered mediations.

At the beginning of the *Engle* Progeny litigation, a central issue was the proper use of the preserved *Engle* findings. RJR Tobacco has argued that use of the *Engle* findings to establish individual elements of progeny claims (such as defect, negligence and concealment) is a violation of federal due process. In 2013, however, both the Florida Supreme Court and the U.S. Court of Appeals for the Eleventh Circuit, referred to as the Eleventh Circuit, rejected that argument. As noted below, the Eleventh Circuit, this time sitting *en banc*, recently heard argument on this issue again. In addition to this global due process argument, RJR Tobacco and Lorillard Tobacco raise many other factual and legal defenses as appropriate in each case. These defenses may include, among other things, arguing that the plaintiff is not a proper member of the *Engle* class, that the plaintiff did not rely on any statements by any tobacco company, that the trial was conducted unfairly, that some or all claims are

preempted or barred by applicable statutes of limitation, or that any injury was caused by the smoker's own conduct. In *Hess v. Philip Morris USA Inc.* and *Russo v. Philip Morris USA Inc.*, decided on April 2, 2015, the Florida Supreme Court held that, in *Engle* Progeny cases, the defendants cannot raise a statute of repose defense to claims for concealment or conspiracy. On April 8, 2015, in *Graham v. R. J. Reynolds Tobacco Co.*, the Eleventh Circuit held that federal law impliedly preempts use of the preserved *Engle* findings to establish claims for strict liability or negligence. On January 21, 2016, the Eleventh Circuit granted the plaintiff's motion for rehearing *en banc* and vacated the panel decision. On March 23, 2016, the Eleventh Circuit requested briefing on the issues of whether plaintiff's claims are preempted and, if not, whether the defendants' due process rights are violated. Oral argument occurred on June 21, 2016. A decision is pending. On January 6, 2016, in *Marotta v. R. J. Reynolds Tobacco Co.*, the Fourth DCA, disagreed with the *Graham* panel decision and held that federal law does not impliedly preempt any tort claims against cigarette manufacturers, including those of *Engle* Progeny plaintiffs. The Florida Supreme Court has accepted jurisdiction in *Marotta,* and oral argument occurred on November 1, 2016. A decision is pending.

In June 2009, Florida amended its existing bond cap statute by adding a $200 million bond cap that applied to all *Engle* Progeny cases in the aggregate. In May 2011, Florida removed the provision that would have allowed the bond cap to expire on December 31, 2012. The bond cap for any given individual *Engle* Progeny case varies depending on the number of judgments on appeal at a given time, but never exceeds $5 million per case for appeals within the Florida state court system. The legislation, which became effective in June 2009 and 2011, applied to judgments entered after the original 2009 effective date. Bills are pending in the Florida legislature that would repeal the $200 million bond cap applicable to *Engle* Progeny cases.

During 2015, RJR Tobacco and Lorillard Tobacco, together with Philip Morris USA Inc., settled virtually all of the *Engle* Progeny cases then pending against them in federal district court. The total amount of the settlement was $100 million divided as follows: RJR Tobacco — $42.5 million; Philip Morris USA Inc. — $42.5 million; and Lorillard Tobacco — $15 million. The settlement covered more than 400 federal progeny cases but did not cover 12 federal progeny cases previously tried to verdict and currently pending on post-trial motions or appeal; and 2 federal progeny cases filed by different lawyers from the ones who negotiated the settlement for the plaintiffs. Between August 3, 2015 and January 4, 2016, RJR Tobacco and Philip Morris USA Inc. removed 39 *Engle* Progeny cases from state to federal courts in Florida. These cases were not part of the settlement described above and were all remanded back to state court.

One hundred twenty *Engle* Progeny cases have been tried in Florida state and federal courts since the beginning of 2014 through December 31, 2016, and additional state court trials are scheduled for 2017. Since the beginning of 2014 through December 31, 2016, RJR Tobacco or Lorillard Tobacco has paid judgments in 37 *Engle* Progeny cases. Those payments totaled $297.8 million and included $216.9 million for compensatory or punitive damages and $80.9 million for attorneys' fees and statutory interest. In addition, accruals for compensatory and punitive damages and attorneys' fees and statutory interest for *Starr-Blundell*, *Buonomo,* and *Ward* (for attorneys' fees and interest only) were recorded in RAI's consolidated balance sheet as of December 31, 2016. The following chart reflects the details of accrued compensatory and punitive damages related to *Starr-Blundell* and *Buonomo.*

Plaintiff Case Name	RJR Tobacco Allocation of Fault	Lorillard Tobacco Allocation of Fault	Compensatory Damages (as adjusted) (1)	Punitive Damages	Appeal Status
Starr-Blundell	10%	—	$ 50,000	$ —	First DCA, *per curiam*, reversed and remanded its May 29, 2015 opinion to the trial court for reconsideration in light of the decision in *Soffer*
Buonomo	77.5%	—	4,060,000	25,000,000	Fourth DCA affirmed the amended final judgment, *per curiam*; RJR Tobacco's motion for rehearing was denied on October 27, 2016; deadline for RJR Tobacco to file a petition for writ of certiorari with the U.S. Supreme Court is March 26, 2017
Totals			$ 4,110,000	$25,000,000	

(1) Compensatory damages are adjusted to reflect the reduction that may be required by the allocation of fault. Punitive damages are not adjusted and reflect the amount of the final judgment(s) signed by the trial court judge(s). The amounts listed above do not include attorneys' fees or statutory interest of approximately $13.3 million or approximately $1.6 million in attorneys' fees and statutory interest in *Ward.*

The following chart lists judgments in all other individual *Engle* Progeny cases pending as of December 31, 2016, in which a verdict or judgment has been returned against RJR Tobacco, B&W, and/or Lorillard Tobacco and the verdict or judgment has not been set aside on appeal. No liability for any of these cases has been recorded in RAI's consolidated balance sheet as of December 31, 2016. This chart does not include the mistrials or verdicts returned in favor of RJR Tobacco, B&W, and/or Lorillard Tobacco.

Plaintiff Case Name	RJR Tobacco Allocation of Fault	Lorillard Tobacco Allocation of Fault	Compensatory Damages (as adjusted) (1)	Punitive Damages	Appeal Status
Putney	30%	—	$ —	$2,500,000	Fourth DCA reinstated the punitive damages awards of $2.5 million each against RJR Tobacco and the remaining defendant; court's opinion that previously granted remittitur of the compensatory damages awards still stands; remanded to trial court for further proceedings
Andy Allen	24%	—	2,475,000	7,756,000	Pending – First DCA

Plaintiff Case Name	RJR Tobacco Allocation of Fault	Lorillard Tobacco Allocation of Fault	Compensatory Damages (as adjusted) (1)	Punitive Damages	Appeal Status
Calloway	27%	18%	—	—	Fourth DCA granted rehearing *en banc* and substituted a new opinion, ordered a new trial based on improper argument; the plaintiff filed a notice to invoke the discretionary jurisdiction of the Florida Supreme Court on October 21, 2016; decision is pending
James Smith . . .	55%	—	600,000(2)	20,000	Pending – Eleventh Circuit
Evers	60%	9%	2,950,000	12,360,000	Second DCA reinstated punitive damage award of $12.36 million the trial court had set aside; the verdict was reinstated on remand; a subsequent appeal is pending in the Second DCA
Schoeff	75%	—	7,875,000	—	Pending – Florida Supreme Court
Marotta	58%	—	3,480,000	—	Pending – Florida Supreme Court
Searcy	30%	—	500,000(2)	1,670,000	Pending – Eleventh Circuit
Earl Graham . .	20%	—	550,000	—	Eleventh Circuit held that federal law impliedly preempts claims for strict liability and negligence based on the defect and negligence findings from *Engle*; plaintiff's motion for rehearing *en banc* was granted; oral argument occurred on June 21, 2016; decision is pending
Skolnick	30%	—	—	—	Fourth DCA set aside judgment and ordered a partial new trial
Grossman	75%	—	11,514,000	22,500,000	Fourth DCA ordered award of compensatory damages reduced to reflect comparative fault, but otherwise affirmed; RJR Tobacco filed a motion for rehearing on February 6, 2017; decision is pending
Gafney	33%	33%	—	—	Fourth DCA reversed the judgment and remanded for a new trial; Florida Supreme Court declined to accept jurisdiction; new trial has not been scheduled
Burkhart	25%	10%	3,500,000(2)	1,750,000	Pending – Eleventh Circuit
Bakst (Odom) . .	75%	—	—	—	Fourth DCA reversed the judgment of the trial court and remanded the case for a new trial on damages only; motion for rehearing was filed on January 9, 2017
Robinson	71%	—	16,900,000	16,900,000	Pending – First DCA
Harris	15%	10%	1,100,000(2)	—	Post-trial motions are pending (3)
Irimi	15%	15%	—	—	Pending – Fourth DCA

Plaintiff Case Name	RJR Tobacco Allocation of Fault	Lorillard Tobacco Allocation of Fault	Compensatory Damages (as adjusted) (1)	Punitive Damages	Appeal Status
Lourie	3%	7%	137,000	—	Second DCA affirmed the final judgment; defendants filed a notice to invoke the discretionary jurisdiction of the Florida Supreme Court on September 8, 2016; Florida Supreme Court stayed proceedings pending disposition of *Marotta*
Kerrivan	31%	—	6,046,660(2)	9,600,000	Post-trial motions are pending (3)
Schleider	70%	—	14,700,000	—	Pending – Third DCA
Perrotto	20%	6%	1,063,000	—	Plaintiff's motion for a new trial granted as to punitive damages; new trial scheduled for June 5, 2017
Ellen Gray	50%	—	3,000,000	—	Post-trial motions are pending (3)
Sowers	50%	—	2,125,000	—	Post-trial motions are pending (3)
Caprio	20%	10%	167,700	—	Appeal in the Fourth DCA dismissed; pending in trial court
Zamboni	30%	—	102,000	—	Final judgment has not been entered
Pollari	43%	—	4,250,000	1,500,000	Pending – Fourth DCA
Gore	23%	—	460,000	—	Pending – Fourth DCA
Ryan	65%	—	13,975,000	25,000,000	Pending – Fourth DCA
Hardin	13%	—	100,880	—	Third DCA remanded the case for a new trial on punitive damages for the non-intentional tort claims; new trial has not been scheduled
McCoy	25%	20%	670,000	6,000,000	Pending – Fourth DCA
Block	50%	—	463,000	800,000	Pending – Fourth DCA
Lewis	25%	—	187,500	—	Pending – Fifth DCA
Cooper	40%	—	1,200,000	—	Pending – Fourth DCA
Duignan	30%	—	2,690,000(2)	2,500,000	Pending – Second DCA
O'Hara	85%	—	14,700,000	20,000,000	Pending – First DCA
Marchese	22.5%	—	225,000	250,000	Pending – Fourth DCA
Barbose	42.5%	—	5,000,000(2)	500,000	Pending – Second DCA
Monroe	58%	—	6,380,000	—	Pending – First DCA
Ledoux	47%	—	5,000,000(2)	12,500,000	Pending – Third DCA
Ewing	2%	—	4,800	—	Post-trial motions denied; final judgment has not been entered
Ahrens	44%	—	5,800,000(2)	2,500,000	Pending – Second DCA
Turner	80%	—	2,400,000	10,000,000	Pending – Fourth DCA
Enochs	66%	—	13,860,000	6,250,000	Pending – Fourth DCA
Dion	75%	—	12,000,000(2)	30,000	Pending – Second DCA
Nally	75%	—	6,000,000(2)	12,000,000	Pending – Second DCA
McCabe	30%	—	1,500,000	6,500,000	Post-trial motions are pending (3)
Sermons	5%	—	3,250	17,075	Post-trial motions are pending (3)
Mathis	55%	—	5,000,000(2)	—	Pending – Third DCA
Oshinsky-Blacker	25%	—	1,539,000	2,000,000	Post-trial motions are pending (3)
Sherry Smith	65%	—	3,000,000(2)	—	Pending – Fifth DCA
Prentice	40%	—	2,560,000	—	Post-trial motions are pending (3)
Konzelman	85%	—	7,476,000	20,000,000	Pending – Fourth DCA
Ledo	49%	—	2,940,000	—	Post-trial motions are pending (3)
Johnston	90%	—	6,750,000	14,000,000	Post-trial motions are pending (3)
Howles	50%	—	2,000,000	3,000,000	Pending – Fourth DCA

Plaintiff Case Name	RJR Tobacco Allocation of Fault	Lorillard Tobacco Allocation of Fault	Compensatory Damages (as adjusted) (1)	Punitive Damages	Appeal Status
Ford	15%	—	153,430	—	Post-trial motions are pending (3)
Martin	22%	—	1,190,400	200,000	Post-trial motions are pending (3)
Pardue	50%	—	3,923,000(2)	6,750,000	Post-trial motions are pending (3)
Totals			$212,186,620	$227,353,075	

(1) Unless otherwise noted, compensatory damages in these cases are adjusted to reflect the jury's allocation of comparative fault. Punitive damages are not so adjusted. The amounts listed above do not include attorneys' fees or statutory interest that may apply to the judgments and such fees and interest may be material.
(2) The court did not apply comparative fault in the final judgment.
(3) Should the pending post-trial motions be denied, RJR Tobacco will likely file a notice of appeal with the appropriate appellate court.

As reflected in the preceding chart, as of December 31, 2016, verdicts or judgments in favor of *Engle* Progeny plaintiffs have been entered and remain outstanding against RJR Tobacco or Lorillard Tobacco totaling $212,186,620 in compensatory damages (as adjusted) and $227,353,075 in punitive damages, which is a combined total of $439,539,695. These verdicts or judgments are at various stages in the post-trial or appellate process. RJR Tobacco believes that RJR Tobacco and Lorillard Tobacco have valid defenses in these cases, including case-specific issues beyond the due process issue discussed above, and, as described in more detail above in "— Accounting for Tobacco-Related Litigation Contingencies," RJR Tobacco and its affiliates vigorously defend smoking and health claims, including *Engle* Progeny cases.

Should RJR Tobacco or Lorillard Tobacco not prevail in any particular individual *Engle* Progeny case or determine that in any individual *Engle* Progeny case an unfavorable outcome has become probable and the amount can be reasonably estimated, a loss would be recognized, which could have a material adverse effect on the results of operations, cash flows and financial position of RAI. This position on loss recognition for *Engle* Progeny cases as of December 31, 2016, is consistent with RAI's and RJR Tobacco's historic position on loss recognition for other smoking and health litigation. It is the policy of RJR Tobacco to record any loss concerning litigation at such time as an unfavorable outcome becomes probable and the amount can be reasonably estimated on an individual case-by-case basis.

Below is a description of the *Engle* Progeny cases against RJR Tobacco, B&W, and/or Lorillard Tobacco that went to trial or were decided during the period from January 1, 2016 to December 31, 2016, or remained on appeal as of December 31, 2016, listed chronologically by the date of the verdict. In each case, the plaintiff: (1) alleged that the smoker was addicted to nicotine in cigarettes and, as a result of that addiction, suffered or died from one or more smoking-related diseases; (2) asserted claims based on theories of negligence, strict liability, and intentional tort; and (3) sought to recover unspecified compensatory damages, as well as attorneys' fees and costs. The plaintiffs in most, but not all, cases also sought to recover punitive damages.

On April 13, 2010, in *Putney v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Broward County, Fla., filed 2007), a jury in Phase I of the trial returned a verdict for the plaintiff. On April 26, 2010, the jury in Phase II of the trial found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $15.1 million in compensatory damages; found the decedent 35% at fault, RJR Tobacco 30% at fault and the remaining defendants collectively 35% at fault; and awarded $2.5 million in punitive damages against each of RJR Tobacco and one of the remaining defendants. In August 2010, the trial court entered final judgment against RJR Tobacco in the amount of $4.5 million in compensatory damages and $2.5 million in punitive damages. In December 2010, the trial court entered an amended final judgment to provide that interest would run from April 26, 2010. In June 2013, the Fourth DCA held that the trial court erred in denying the defendants' motion for remittitur of the compensatory damages for loss of consortium and in striking the defendants' statute of repose affirmative defenses. As a result, the Fourth DCA reversed and remanded for further proceedings. After its April 2, 2015, ruling in *Hess v. Philip Morris USA Inc.* that *Engle* Progeny defendants cannot raise a statute of repose defense to claims for concealment or conspiracy, the Florida Supreme Court, on February 1, 2016, accepted jurisdiction in *Putney*, quashed the Fourth DCA's decision and reinstated the verdict. On March 15, 2016, the Florida Supreme Court granted the defendants' motion for clarification in an order stating that remand was for reconsideration only on the issue of the statute of repose. On August 31, 2016, the Fourth DCA entered a new opinion following remand from the Florida Supreme Court. The court reinstated the punitive damages awards of $2.5 million each against RJR Tobacco and the remaining defendant. The court's opinion that previously granted remittitur of the compensatory damages awards still stands. The matter is remanded to the trial court for further proceedings.

On April 21, 2010, in *Grossman v. R. J. Reynolds Tobacco Co*. (Cir. Ct. Broward County, Fla., filed 2007), the jury, in Phase I of a retrial that followed a mistrial, returned a verdict for the plaintiff. On April 29, 2010, the jury in Phase II of the retrial found for the plaintiff on the strict liability claim and for RJR Tobacco on the negligence, warranty, and intentional tort claims; awarded $1.9 million in compensatory damages; found RJR Tobacco 25% at fault, the decedent 70% at fault, and the decedent's spouse 5% at fault; and did not reach the issue of entitlement to punitive damages. In June 2010, the trial court entered final judgment against RJR Tobacco in the amount of approximately $484,000 in compensatory damages. In June 2012, the Fourth DCA affirmed the trial court's judgment, but remanded for a new trial on all Phase II issues. On July 31, 2013, the jury in the second retrial found for the plaintiff on the intentional tort claims, awarded $15.35 million in compensatory damages, found the decedent 25% at fault and RJR Tobacco 75% at fault, and awarded $22.5 million in punitive damages. The trial court entered final judgment in August 2013 and did not include a reduction for comparative fault. RJR Tobacco appealed, posted a supersedeas bond in the amount of $5 million, and the plaintiff cross appealed. On January 4, 2017, the Fourth DCA ordered the award of compensatory damages be reduced to reflect the comparative fault allocation assigned by the jury, but otherwise affirmed the final judgment. RJR Tobacco filed a motion for rehearing on February 6, 2017. A decision is pending.

On May 20, 2010, in *Buonomo v. R. J. Reynolds Tobacco Co*. (Cir. Ct. Broward County, Fla., filed 2007), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $5.2 million in compensatory damages; found RJR Tobacco 77.5% at fault and the decedent 22.5% at fault; and awarded $25 million in punitive damages. In accordance with a Florida statute, the trial court later reduced the punitive damage award to $15.7 million — three times the compensatory damages award of $5.2 million and entered final judgment in the amount of $4.06 million in compensatory damages and $15.7 million in punitive damages. In September 2013, the Fourth DCA affirmed the judgment and damages award to the plaintiff on strict liability and negligence, held that the trial court was not bound to hold punitive damages at three times compensatory damages, and reversed the judgment entered for the plaintiff on the claims for fraudulent concealment and conspiracy to commit fraud by concealment due to the erroneous striking of RJR Tobacco's statute of repose defense. As a result, the punitive damages award was set aside and remanded for a new trial. In October 2014, the trial court found that the original $25 million punitive damages award was not excessive and would be reinstated if the plaintiff prevails on the repose issue and, in April 2015, entered an amended judgment against RJR Tobacco in the amount of approximately $29.1 million from which RJR Tobacco appealed. After its April 2, 2015, ruling in *Hess v. Philip Morris USA Inc.* that *Engle* Progeny defendants cannot raise a statute of repose defense to claims for concealment or conspiracy, the Florida Supreme Court, on January 26, 2016, accepted jurisdiction in *Buonomo*, quashed the Fourth DCA's decision, and reinstated the jury verdict. RJR Tobacco's motion for clarification was denied on March 21, 2016. In the appeal of the amended final judgment, on September 22, 2016, the Fourth DCA affirmed the amended final judgment, *per curiam*. RJR Tobacco's motion for rehearing was denied in October 2016. The deadline for RJR Tobacco to file a petition for writ of certiorari with the U.S. Supreme Court is March 26, 2017.

On October 15, 2010, in *Frazier v. Philip Morris USA Inc*. (Cir. Ct. Miami-Dade County, Fla., filed 2007), a case now known as *Russo v. Philip Morris USA Inc.*, a jury found for the defendants based on the statute of limitations. In February 2011, the trial court entered final judgment for the defendants. In April 2012, the Third DCA reversed the trial court's judgment, directed entry of judgment in the plaintiff's favor and ordered a new trial. On April 2, 2015, the Florida Supreme Court, in its ruling in *Hess v. Philip Morris USA Inc.*, approved the decision of the Third DCA. On April 23, 2015, the jury found for the defendants, including RJR Tobacco, on the issue of addiction causation, and the trial court entered final judgment for the defendants in May 2015. In June 2015, the plaintiff appealed to the Third DCA, and the defendants cross appealed. On October 19, 2016, the Third DCA affirmed the final judgment of the trial court. The plaintiff did not seek further review.

On April 26, 2011, in *Andy Allen v. R. J. Reynolds Tobacco Co*. (Cir. Ct. Duval County, Fla., filed 2007), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $6 million in compensatory damages; found RJR Tobacco 45% at fault, the decedent 40% at fault, and the remaining defendant 15% at fault; and awarded $17 million in punitive damages against each defendant. The trial court entered final judgment against RJR Tobacco in the amount of $19.7 million in May 2011 and, in October 2011, entered a remittitur of the punitive damages to $8.1 million. In May 2013, the First DCA reversed and remanded the case for a new trial. On November 24, 2014, the jury in the retrial found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $3.1 million in compensatory damages; found the decedent 70% at fault, RJR Tobacco 24% at fault, and the remaining defendant to be 6% at fault; and found that the plaintiff was entitled to punitive damages. On November 26, 2014, the jury awarded approximately $7.75 million in punitive damages against each defendant. In August 2015, the trial court entered final judgment against RJR

Tobacco and the remaining defendant, jointly and severally, in the amount of approximately $3.1 million in compensatory damages and $7.75 million in punitive damages from each defendant. In September 2015, the defendants filed a notice of appeal to the First DCA, and RJR Tobacco posted a supersedeas bond in the amount of approximately $2.5 million. Oral argument occurred on November 2, 2016. A decision is pending.

On May 17, 2012, in *Calloway v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Broward County, Fla., filed 2007), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $20.5 million in compensatory damages; found the decedent 20.5% at fault, RJR Tobacco 27% at fault, Lorillard Tobacco 18% at fault, and the remaining defendants collectively 34.5% at fault; and found that the plaintiff was entitled to punitive damages. On May 31, 2012, the jury awarded punitive damages in the amount of $17.25 million against RJR Tobacco, $12.6 million against Lorillard Tobacco, and $25 million collectively against the remaining defendants. The trial court later determined that the jury's apportionment of comparative fault did not apply to the compensatory damages award and, in August 2012, entered final judgment. On January 6, 2016, the Fourth DCA reversed the fraudulent concealment and conspiracy claims, reversed the punitive damages award, and remanded the case for a new trial on those issues. On September 23, 2016, the Fourth DCA, sitting *en banc,* reversed the judgment in its entirety and remanded the case for a new trial. The new trial has not been scheduled. The plaintiff filed a notice to invoke the discretionary jurisdiction of the Florida Supreme Court on October 21, 2016. A decision is pending.

On October 17, 2012, in *James Smith v. R. J. Reynolds Tobacco Co*. (U.S.D.C. M.D. Fla., filed 2007), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $600,000 in compensatory damages; found the decedent 45% at fault and RJR Tobacco 55% at fault; and found that the plaintiff was entitled to punitive damages. On October 18, 2012, the jury awarded $20,000 in punitive damages. The trial court entered final judgment against RJR Tobacco in the amount of $620,000. RJR Tobacco appealed to the Eleventh Circuit and posted a supersedeas bond in the amount of approximately $620,000. Oral argument occurred on October 17, 2014. A decision is pending.

On February 11, 2013, in *Evers v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Hillsborough County, Fla., filed 2007), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $3.23 million in compensatory damages; found the decedent 31% at fault, RJR Tobacco 60% at fault and Lorillard Tobacco 9% at fault; and found that the plaintiff was entitled to punitive damages from RJR Tobacco but not from Lorillard Tobacco. On February 12, 2013, the jury awarded $12.36 million in punitive damages against RJR Tobacco. In March 2013, the trial court granted the defendants' post-trial motions for directed verdict on fraudulent concealment, conspiracy and punitive damages and set aside the $12.36 million punitive damages award. The trial court entered final judgment in the amount of $1.77 million against RJR Tobacco and approximately $266,000 against Lorillard Tobacco. On November 6, 2015, the Second DCA concluded that the trial court erred in granting the defendants' motion for directed verdict on claims for fraud by concealment and conspiracy to commit fraud by concealment, and reversed and reinstated the jury's verdict on those two claims. As a result, the punitive damages award was reinstated. On remand, the jury's verdict was reinstated. On March 14, 2016, the trial court entered an amended final judgment against RJR Tobacco in the amount of $2.95 million in compensatory damages and $12.36 million in punitive damages. In April 2016, RJR Tobacco appealed to the Second DCA and posted a supersedeas bond in the amount of $5 million. Oral argument occurred on February 7, 2017. A decision is pending.

On February 13, 2013, in *Schoeff v. R. J. Reynolds Tobacco Co*. (Cir. Ct. Broward County, Fla., filed 2007), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $10.5 million in compensatory damages; found the decedent 25% at fault and RJR Tobacco 75% at fault; and found that the plaintiff was entitled to punitive damages. On February 14, 2013, the jury awarded $30 million in punitive damages. In April 2013, the trial court entered final judgment against RJR Tobacco in the amount of $7.88 million in compensatory damages and $30 million in punitive damages. On November 4, 2015, the Fourth DCA reversed the punitive damages portion of the final judgment and remanded the case to the trial court, directing the trial court to grant RJR Tobacco's motion for remittitur and, if RJR Tobacco does not agree with the remitted amount, to hold a new trial on punitive damages. On May 26, 2016, the Florida Supreme Court accepted jurisdiction of the case. Oral argument is scheduled for March 8, 2017.

On March 20, 2013, in *Marotta v. R. J. Reynolds Tobacco Co*. (Cir. Ct. Broward County, Fla., filed 2007), the jury, in a retrial following a mistrial, found for the plaintiff on the strict liability claim and for RJR Tobacco on the negligence and intentional tort claims, awarded $6 million in compensatory damages, found the decedent 42% at fault and RJR Tobacco 58% at fault, and did not reach the issue of entitlement to punitive damages. The trial court later entered final judgment against RJR Tobacco in the amount of $3.48 million. On January 6, 2016,

the Fourth DCA affirmed, disagreeing with the Eleventh Circuit panel decision in *Graham*, discussed below, regarding whether the plaintiff's claims are preempted. On March 8, 2016, the Florida Supreme Court accepted jurisdiction of the case. Oral argument occurred on November 1, 2016. A decision is pending.

On April 1, 2013, in *Searcy v. R. J. Reynolds Tobacco Co.* (U.S.D.C. M.D. Fla., filed 2008), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $6 million in compensatory damages; found the decedent 40% at fault, RJR Tobacco 30% at fault and the remaining defendant 30% at fault; and awarded $10 million in punitive damages against each defendant. The trial court later entered final judgment against RJR Tobacco in the amount of $6 million in compensatory damages and $10 million in punitive damages. In September 2013, the trial court granted the defendants' motion for a new trial, or in the alternative, reduction or remittitur of the damages awarded to the extent it sought remittitur of the damages. The compensatory damage award was remitted to $1 million, and the punitive damage award was remitted to $1.67 million against each defendant. The plaintiff filed a notice of acceptance of remittitur in November 2013, and the trial court issued an amended final judgment. The defendants appealed to the Eleventh Circuit, and RJR Tobacco posted a supersedeas bond in the amount of approximately $2.2 million. Oral argument occurred on October 17, 2014. A decision is pending.

On May 2, 2013, in *David Cohen v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Palm Beach County, Fla., filed 2007), a jury found for the plaintiff on the negligence and strict liability claims and for the defendants on the intentional tort claims; awarded $2.06 million in compensatory damages; found the decedent 40% at fault, RJR Tobacco 30% at fault, Lorillard Tobacco 20% at fault and the remaining defendant 10% at fault; and did not reach the issue of entitlement to punitive damages. In May 2013, the trial court entered final judgment against RJR Tobacco in the amount of $617,000 and against Lorillard Tobacco in the amount of approximately $411,000. In July 2013, the court granted the defendants' motion for a new trial due to the plaintiff's improper arguments during closing. The new trial date has not been scheduled. The plaintiff filed a notice of appeal to the Fourth DCA, and the defendants filed a notice of cross appeal. On September 7, 2016, the Fourth DCA affirmed the trial court's order granting RJR Tobacco's motion for a new trial. The plaintiff filed a notice to invoke the discretionary jurisdiction of the Florida Supreme Court on October 10, 2016. A decision is pending.

On May 23, 2013, in *Earl Graham v. R. J. Reynolds Tobacco Co.* (U.S.D.C. M.D. Fla., filed 2008), a jury found for the plaintiff on the negligence and strict liability claims and for the defendants on the intentional tort claims; awarded $2.75 million in compensatory damages; found the decedent 70% at fault, RJR Tobacco 20% at fault, and the remaining defendant 10% at fault, and did not reach the issue of entitlement to punitive damages. In May 2013, the trial court entered final judgment against RJR Tobacco in the amount of $550,000. On April 8, 2015, the Eleventh Circuit reversed and ordered entry of judgment for RJR Tobacco. The Eleventh Circuit held that federal law impliedly preempts claims for strict liability and negligence based on the defect and negligence findings from *Engle*. On January 21, 2016, the plaintiff's motion for rehearing *en banc* was granted, and the panel's decision was vacated. On March 23, 2016, the Eleventh Circuit requested briefing on the issues of whether plaintiff's claims are preempted and, if not, whether the defendants' due process rights are violated. Oral argument occurred on June 21, 2016. A decision is pending.

On June 4, 2013, in *Starr-Blundell v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Duval County, Fla., filed 2007), a jury found for the plaintiff on the negligence and strict liability claims and for the defendants on the intentional tort claims; awarded $500,000 in compensatory damages; found the decedent 80% at fault, RJR Tobacco 10% at fault and the remaining defendant 10% at fault; and did not reach the issue of entitlement to punitive damages. In November 2013, the trial court entered final judgment in the amount of $50,000 against each defendant. On May 29, 2015, the First DCA affirmed the final judgment of the trial court, *per curiam*. On June 29, 2015, the plaintiff filed a notice to invoke the discretionary jurisdiction of the Florida Supreme Court. On May 24, 2016, the Florida Supreme Court accepted jurisdiction of the case, quashed the decision of the First DCA, and remanded the case for reconsideration in light of *Soffer*. On September 6, 2016, the First DCA, *per curiam*, reversed and remanded its May 29, 2015 opinion to the trial court for reconsideration in light of the decision in *Soffer*. The trial court is considering the parties' submissions regarding next steps in the case.

On June 14, 2013, in *Skolnick v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Palm Beach County, Fla., filed 2007), a jury found for the plaintiff on the negligence and strict liability claims and for the defendants on the intentional tort claims; awarded $2.56 million in compensatory damages; found the decedent 40% at fault, RJR Tobacco 30% at fault and the remaining defendant 30% at fault; and did not reach the issue of entitlement to punitive damages. In July 2013, the trial court entered final judgment against RJR Tobacco in the amount of $766,500. On July 15, 2015, the Fourth DCA set aside the judgment and ordered a partial new trial finding that the strict liability and negligence claims, on which the plaintiff had prevailed, were barred by a prior settlement entered

into by the plaintiff in a separate action. The Fourth DCA also held that the plaintiff's concealment and conspiracy claims, on which the defendants had prevailed, must be re-tried due to an erroneous jury instruction on the statute of repose. The new trial has not been scheduled.

On September 20, 2013, in *Gafney v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Palm Beach County, Fla., filed 2007), a jury found for the plaintiff on the negligence and strict liability claims and for the defendants on the intentional tort claims; awarded $5.8 million in compensatory damages; found the decedent 34% at fault, RJR Tobacco 33% at fault and Lorillard Tobacco 33% at fault; and did not reach the issue of entitlement to punitive damages. In September 2013, the trial court entered final judgment against RJR Tobacco in the amount of $1.9 million and against Lorillard Tobacco in the amount of $1.9 million. On March 23, 2016, the Fourth DCA reversed the judgment of the trial court and remanded for a new trial due to improper comments made to the jury during plaintiff's counsel's closing arguments. In August 2016, the Florida Supreme Court declined to accept jurisdiction of the case. The new trial has not been scheduled.

On February 27, 2014, in *Banks v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Broward County, Fla., filed 2007), a jury found for the plaintiff on the negligence and strict liability claims and for the defendants on the intentional tort claims; awarded $0 in compensatory damages; found the decedent 85% at fault, RJR Tobacco 15% at fault, and the remaining defendant 0% at fault; and did not reach the issue of entitlement to punitive damages. In May 2014, the trial court entered final judgment in favor of RJR Tobacco and the other defendant. The plaintiff appealed to the Fourth DCA, and the defendants cross appealed. On October 20, 2016, the Fourth DCA affirmed the judgment of the trial court, *per curiam*. The plaintiff did not seek further review.

On May 15, 2014, in *Burkhart v. R. J. Reynolds Tobacco Co.* (U.S.D.C. M.D. Fla., filed 2008), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $5 million in compensatory damages; found the plaintiff 50% at fault, RJR Tobacco 25% at fault, Lorillard Tobacco 10% at fault and the remaining defendant 15% at fault; and found that the plaintiff was entitled to punitive damages. On May 16, 2014, the jury awarded punitive damages of $1.25 million against RJR Tobacco, $500,000 against Lorillard Tobacco, and $750,000 against the remaining defendant. In June 2014, the trial court entered final judgment without a reduction for comparative fault. The defendants appealed to the Eleventh Circuit. Oral argument occurred on September 29, 2015. A decision is pending.

On June 23, 2014, in *Bakst v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Palm Beach County, Fla., filed 2007), a case now known as *Odom v. R. J. Reynolds Tobacco Co.*, a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded approximately $6 million in compensatory damages; found the decedent 25% at fault and RJR Tobacco 75% at fault; and found that the plaintiff was entitled to punitive damages. On June 23, 2014, the jury awarded $14 million in punitive damages. The trial court later entered final judgment against RJR Tobacco in the amount of $4.5 million in compensatory damages and $14 million in punitive damages. RJR Tobacco appealed to the Fourth DCA and posted a supersedeas bond in the amount of $5 million. On November 30, 2016, the Fourth DCA reversed the trial court's judgment and remanded the case with directions that the trial court grant the motion for remittitur or order a new trial on damages only. RJR Tobacco filed a motion for rehearing on January 9, 2017, requesting that the Fourth DCA grant rehearing or withdraw the section of its opinion addressing the propriety of the plaintiff's closing argument or grant rehearing *en banc* on the improper argument issue. A decision is pending.

On July 17, 2014, in *Robinson v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Escambia County, Fla., filed 2008), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $16.9 million in compensatory damages; found the decedent 29.5% at fault and RJR Tobacco 70.5% at fault; and found that the plaintiff was entitled to punitive damages. On July 18, 2014, the jury awarded $23.6 billion in punitive damages. In July 2014, the trial court entered partial judgment on compensatory damages against RJR Tobacco in the amount of $16.9 million. On January 27, 2015, the trial court remitted the punitive damages award to approximately $16.9 million. In February 2015, RJR Tobacco filed an objection to the remitted award of punitive damages and a demand for a new trial on damages. The trial court granted a new trial on the amount of punitive damages only. The new trial on punitive damages has been stayed pending RJR Tobacco's appeal to the First DCA of the partial judgment of compensatory damages and of the order granting a new trial on the amount of punitive damages only. RJR Tobacco posted a supersedeas bond in the amount of $5 million. Briefing on the merits is complete. Oral argument occurred on May 24, 2016. A decision is pending.

On July 31, 2014, in *Harris v. R. J. Reynolds Tobacco Co.* (U.S.D.C. M.D. Fla., filed 2008), a jury found for the plaintiff on the negligence and strict liability claims and for the defendants on the intentional tort claims; awarded $400,000 in compensatory damages for the wrongful death claim and $1.3 million in compensatory damages for the survival claim; allocated fault to the decedent (60% survival/70% wrongful death), RJR Tobacco

(15% survival/10% wrongful death), Lorillard Tobacco (10% survival/10% wrongful death), and the remaining defendant (15% survival/10% wrongful death), and found that the plaintiff was not entitled to punitive damages. In December 2014, the trial court entered final judgment. Post-trial motions are pending, but in April 2015, the court stayed all post-trial proceedings pending resolution of the petition for *en banc* consideration in *Graham*, described above.

On August 27, 2014, in *Wilcox v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Miami-Dade County, Fla., filed 2008), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $7 million in compensatory damages; found the decedent 30% at fault and RJR Tobacco 70% at fault; and found that the plaintiff was entitled to punitive damages. On August 28, 2014, the jury awarded $8.5 million in punitive damages. In September 2014, final judgment was entered against RJR Tobacco in the amount of $4.9 million in compensatory damages and $8.5 million in punitive damages. RJR Tobacco appealed to the Third DCA and posted a supersedeas bond in the amount of $5 million. On July 27, 2016, the Third DCA affirmed the final judgment, *per curiam*. After further evaluation of the case, RJR Tobacco paid approximately $17 million in satisfaction of the judgment on October 27, 2016.

On August 28, 2014, in *Irimi v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Broward County, Fla., filed 2007), a jury found for the plaintiff on the negligence, strict liability, and certain intentional tort claims and for one or more defendants on certain intentional tort claims; awarded approximately $3.1 million in compensatory damages; found the decedent 70% at fault, RJR Tobacco 14.5% at fault, Lorillard Tobacco 14.5% at fault and the remaining defendant 1% at fault; and did not reach the issue of entitlement to punitive damages. The trial court entered final judgment against each of RJR Tobacco and Lorillard Tobacco in the amount of approximately $453,000 and against the remaining defendant in the amount of approximately $31,000. On January 29, 2015, the court granted the defendants' motion for a new trial. The plaintiff appealed to the Fourth DCA, and the defendants cross appealed. Briefing is complete. Oral argument has not been scheduled.

On October 10, 2014, in *Lourie v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Hillsborough County, Fla., filed 2007), a jury found for the plaintiff on the negligence and strict liability claims and for the defendants on the intentional tort claims; awarded approximately $1.37 million in compensatory damages; found the decedent 63% at fault, RJR Tobacco 3% at fault, Lorillard Tobacco 7% at fault and the remaining defendant 27% at fault; and found that the plaintiff was not entitled to punitive damages. The trial court later entered final judgment. The defendants appealed to the Second DCA in November 2014. RJR Tobacco posted a supersedeas bond in the amount of approximately $41,000, and Lorillard Tobacco posted a supersedeas bond in the amount of $96,000. On August 10, 2016, the Second DCA affirmed the final judgment. The defendants filed a notice to invoke the discretionary jurisdiction of the Florida Supreme Court on September 8, 2016. On September 9, 2016, the Florida Supreme Court stayed proceedings pending disposition of *Marotta v. R. J. Reynolds Tobacco Co.,* described above.

On October 20, 2014, in *Kerrivan v. R. J. Reynolds Tobacco Co.* (U.S.D.C. M.D. Fla., filed 2008), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $15.8 million in compensatory damages; found the plaintiff 19% at fault, RJR Tobacco 31% at fault and the remaining defendant 50% at fault; and found that the plaintiff was entitled to punitive damages. On October 22, 2014, the jury awarded $9.6 million in punitive damages against RJR Tobacco and $15.7 million against the remaining defendant. In November 2014, the trial court entered final judgment. RJR Tobacco filed its post-trial motions on December 11, 2014. In May 2015, the trial court deferred briefing and directed the parties to notify the court when the mandate has been issued in *Graham* or *Searcy*, described above.

On November 5, 2014, in *Bishop v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Orange County, Fla., filed 2007), a jury found that the decedent was not a class member, which resulted in a verdict for the defendants, including RJR Tobacco. In November 2014, the trial court entered final judgment. The plaintiff appealed to the Fifth DCA, and the defendants cross appealed. On September 27, 2016, the Fifth DCA affirmed the final judgment, *per curiam*. The plaintiff did not seek further review.

On November 18, 2014, in *Schleider v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Miami-Dade County, Fla., filed 2008), a jury found for the plaintiff on the negligence, strict liability, and certain intentional tort claims and for RJR Tobacco on certain intentional tort claims, awarded $21 million in compensatory damages, found the decedent 30% at fault and RJR Tobacco 70% at fault, and found that the plaintiff was not entitled to punitive damages. In June 2015, the trial court entered final judgment against RJR Tobacco in the amount of $14.7 million. RJR Tobacco appealed to the Third DCA and posted a supersedeas bond in the amount of $5 million. Briefing is underway.

On November 21, 2014, in *Perrotto v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Palm Beach County, Fla., filed 2007), a jury found for the plaintiff on the negligence and strict liability claims and for the defendants on the intentional tort claims; awarded $4.1 million in compensatory damages; found the decedent 49% at fault, RJR Tobacco 20% at fault, Lorillard Tobacco 6% at fault and the remaining defendant 25% at fault; and did not reach the issue of entitlement to punitive damages. Final judgment was entered against RJR Tobacco in the amount of approximately $818,000 and against Lorillard Tobacco in the amount of approximately $245,000. In May 2016, the court granted the plaintiff's motion for a new trial on punitive damages but denied it in all other respects. The new trial is scheduled to begin June 5, 2017.

On December 19, 2014, in *Haliburton v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Palm Beach County, Fla., filed 2008), a jury found that the plaintiff's claims were time-barred, which resulted in a verdict for RJR Tobacco. On April 14, 2015, the trial court entered final judgment in favor of RJR Tobacco. The plaintiff appealed to the Fourth DCA, and RJR Tobacco cross appealed. Briefing is complete. On December 1, 2016, the Fourth DCA entered an order dispensing with oral argument. A decision is pending.

On January 29, 2015, in *Ellen Gray v. R. J. Reynolds Tobacco Co.* (U.S.D.C. M.D. Fla., filed 2008), a jury found for the plaintiff on the negligence and strict liability claims and for RJR Tobacco on the intentional tort claims, awarded $6 million in compensatory damages, and found the decedent 50% at fault and RJR Tobacco 50% at fault. Although the jury ignored an instruction on the verdict form and found that the plaintiff was entitled to punitive damages, there was no punitive damage award. In February 2015, the trial court entered final judgment against RJR Tobacco in the amount of $3 million. Post-trial motions are pending. On June 10, 2015, the court granted RJR Tobacco's motion to stay the case pending resolution of the petition for *en banc* consideration in *Graham*, described above.

On February 10, 2015, in *Hecht v. R. J. Reynolds Tobacco Co*. (U.S.D.C. M.D. Fla., filed 2008), a jury found that the plaintiff's claims were time-barred, which resulted in a verdict in favor of RJR Tobacco. Post-trial proceedings have been stayed until resolution of the petition for *en banc* consideration in *Graham*, described above. However, the trial court entered final judgment in favor of RJR Tobacco on January 7, 2016. On February 2, 2016, the plaintiff appealed to the Eleventh Circuit. Oral argument occurred on January 26, 2017. A decision is pending.

On February 11, 2015, in *Sowers v. R. J. Reynolds Tobacco Co.* (U.S.D.C. M.D. Fla., filed 2008), a jury found for the plaintiff on the negligence and strict liability claims and for RJR Tobacco on the intentional tort claims, awarded $4.25 million in compensatory damages, found the decedent 50% at fault and RJR Tobacco 50% at fault, and did not reach the issue of entitlement to punitive damages. On February 12, 2015, the trial court entered final judgment against RJR Tobacco in the amount of approximately $2.13 million. Post-trial motions are pending. On April 17, 2015, the court stayed post-trial proceedings until resolution of the petition for *en banc* consideration in *Graham*, described above.

On February 24, 2015, in *Caprio v. R. J. Reynolds Tobacco Co*. (Cir. Ct. Broward County, Fla., filed 2007), a jury advised the trial court that it could not reach a unanimous verdict, but the trial court directed the jury to complete the verdict form on those individual verdict questions where there was unanimous agreement. In the partially completed verdict, the jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; found the plaintiff 40% at fault, RJR Tobacco 20% at fault, Lorillard Tobacco 10% at fault, and the remaining defendants 30% at fault; and awarded $559,000 in economic damages. The jury did not answer the verdict form questions relating to noneconomic damages and entitlement to punitive damages. In May 2015, the court denied the defendants' motion for a mistrial and advised that it accepted the questions answered by the jurors as a partial verdict. A new trial will be held on the remaining issues, including comparative fault allocation. The defendants appealed to the Fourth DCA. On January 22, 2017, the defendants dismissed their appeal. The case remains pending in the trial court.

On February 26, 2015, in *Zamboni v. R. J. Reynolds Tobacco Co.* (U.S.D.C. M.D. Fla., filed 2008), a jury found for the plaintiff on the negligence and strict liability claims and for the defendants on the intentional tort claims; awarded the plaintiff $340,000 in compensatory damages; found the decedent 60% at fault, RJR Tobacco 30% at fault and the remaining defendant 10% at fault; and did not reach the issue of entitlement to punitive damages. Post-trial motions are pending. The court stayed the case pending resolution of the petition for *en banc* consideration in *Graham*, described above.

On March 23, 2015, in *Pollari v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Broward County, Fla., filed 2007), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $10 million in compensatory damages; found the decedent 15% at fault, RJR Tobacco 42.5% at fault and the remaining

defendant 42.5% at fault; and found that the plaintiff was entitled to punitive damages. On March 25, 2015, the jury awarded $1.5 million in punitive damages against each defendant. The trial court later entered final judgment against the defendants in the amount of $10 million in compensatory damages and, against each defendant, $1.5 million in punitive damages. On January 12, 2016, the trial court entered a second amended final judgment against RJR Tobacco that awarded $4.25 million in compensatory damages and $1.5 million in punitive damages. The defendants appealed to the Fourth DCA, RJR Tobacco posted a supersedeas bond in the amount of $2.5 million, and the plaintiff cross appealed. Briefing is complete. Oral argument has not been scheduled.

On March 26, 2015, in *Gore v. R. J. Reynolds Tobacco Co*. (Cir. Ct. Indian River County, Fla., filed 2008), a jury, in a retrial following a mistrial, found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $2 million in compensatory damages; found the decedent 54% at fault, RJR Tobacco 23% at fault and the remaining defendant 23% at fault; and found that the plaintiff was not entitled to punitive damages. In September 2015, the trial court entered final judgment against RJR Tobacco and the remaining defendant, each in the amount of $460,000. RJR Tobacco posted a supersedeas bond in the amount of $460,000 in September 2015, and in October 2015, the defendants appealed to the Fourth DCA, and the plaintiff cross appealed. Briefing is underway.

On April 17, 2015, in *Ryan v. R. J. Reynolds Tobacco Co*. (Cir. Ct. Broward County, Fla., filed 2007), a jury, in a retrial following a mistrial, found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $21.5 million in compensatory damages; found the plaintiff 35% at fault and RJR Tobacco 65% at fault; and found that the plaintiff was entitled to punitive damages. On April 21, 2015, the jury awarded $25 million in punitive damages. In May 2015, the trial court entered final judgment against RJR Tobacco in the amount of $21.5 million in compensatory damages and $25 million in punitive damages. On April 29, 2016, the court entered an amended final judgment against RJR Tobacco in the amount of approximately $14 million in compensatory damages and $25 million in punitive damages. RJR Tobacco filed a notice of appeal to the Fourth DCA and posted a supersedeas bond in the amount of $5 million on May 27, 2016. The plaintiff filed a notice of cross appeal on June 13, 2016. Briefing is underway.

On June 18, 2015, in *Hardin v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Miami-Dade County, Fla., filed 2007), a jury found for the plaintiff on the negligence and strict liability claims and for RJR Tobacco on the intentional tort claims, awarded $776,000 in compensatory damages, found the decedent 87% at fault and RJR Tobacco 13% at fault, and found that the plaintiff was not entitled to punitive damages. In June 2015, the trial court entered final judgment against RJR Tobacco in the amount of $100,880. Post-trial motions were denied in January 2016. The plaintiff appealed to the Third DCA, and RJR Tobacco cross appealed. Oral argument occurred on December 7, 2016. On December 21, 2016, the Third DCA remanded the case for a new trial limited to the issue of punitive damages for the plaintiff's non-intentional tort claims. Otherwise, the final judgment was affirmed. Neither party sought further review. The new trial has not been scheduled.

On July 13, 2015, in *McCoy v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Broward County, Fla., filed 2007), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $1.5 million in compensatory damages; found the decedent 35% at fault, RJR Tobacco 25% at fault, Lorillard Tobacco 20% at fault and the remaining defendant 20% at fault; and found that the plaintiff was entitled to punitive damages. On July 17, 2015, the jury awarded $3 million in punitive damages against each defendant. In August 2015, the trial court entered final judgment against RJR Tobacco, RJR Tobacco as successor-by-merger to Lorillard Tobacco, and the remaining defendant, jointly and severally, in the amount of $1.5 million in compensatory damages and, against each of them, $3 million in punitive damages. On January 4, 2016, the trial court entered an amended final judgment in the amount of $370,000 in compensatory damages and $3 million in punitive damages against RJR Tobacco, $300,000 in compensatory damages and $3 million in punitive damages against RJR Tobacco as successor-by-merger to Lorillard Tobacco, and $300,000 in compensatory damages and $3 million in punitive damages against the remaining defendant. RJR Tobacco appealed to the Fourth DCA and posted a supersedeas bond in the amount of approximately $3.35 million, and the plaintiff filed a notice of cross appeal. Briefing is underway.

On July 29, 2015, in *Collar v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Indian River County, Fla., filed 2008), a jury found that the plaintiff was not a class member, which resulted in a verdict for the defendants, including RJR Tobacco. In September 2015, the trial court entered final judgment. The plaintiff appealed to the Fourth DCA, and the defendants cross appealed. Oral argument is scheduled for March 22, 2017.

On August 6, 2015, in *Block v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Broward County, Fla., filed 2007), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded approximately

$1.03 million in compensatory damages; found the decedent 50% at fault and RJR Tobacco 50% at fault; and found that the plaintiff was entitled to punitive damages. On August 7, 2015, the jury awarded $800,000 in punitive damages. In September 2015, the trial court entered final judgment against RJR Tobacco in the amount of approximately $926,000 in compensatory damages and $800,000 in punitive damages. On December 9, 2015, the trial court granted RJR Tobacco's motion to alter or amend the judgment in part in light of the Fourth DCA's decision in *Schoeff v. R. J. Reynolds Tobacco Co.*, described above, finding that the intentional tort exception in Section 768.81, Florida Statutes, does not apply to the fraud and conspiracy claims brought by *Engle* Progeny plaintiffs. As a result, an amended final judgment was entered in the amount of approximately $463,000 in compensatory damages and $800,000 in punitive damages. RJR Tobacco appealed to the Fourth DCA and posted a supersedeas bond in the amount of approximately $1.3 million, and the plaintiff filed a notice of cross appeal. Briefing is complete. On February 3, 2017, the Fourth DCA entered an order dispensing with oral argument. A decision is pending.

On September 1, 2015, in *Lewis v. R. J. Reynolds Tobacco Co*. (Cir. Ct. Volusia County, Fla., filed 2007), a jury found for the plaintiff on the negligence and strict liability claims and for RJR Tobacco on the intentional tort claims, awarded $750,000 in compensatory damages, found the decedent 75% at fault and RJR Tobacco 25% at fault, and found that the plaintiff was not entitled to punitive damages. Final judgment was entered against RJR Tobacco in the amount of $187,500 in March 2016. RJR Tobacco appealed to the Fifth DCA and posted a supersedeas bond in the amount of $187,500. Briefing is complete. Oral argument has not been scheduled.

On September 8, 2015, in *Cooper v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Broward County, Fla., filed 2007), a jury found for the plaintiff on the negligence and strict liability claims and for the defendants on the intentional tort claims; awarded $4.5 million in compensatory damages; found the plaintiff 50% at fault, RJR Tobacco 40% at fault and the remaining defendant 10% at fault; and did not reach the issue of entitlement to punitive damages. Post-trial motions were denied on December 2, 2015. In February 2016, the trial court entered final judgment against RJR Tobacco in the amount of approximately $1.2 million. The defendants appealed to the Fourth DCA, and the plaintiff cross appealed. RJR Tobacco posted a supersedeas bond in the amount of approximately $1.2 million. Briefing is complete. Oral argument has not been scheduled.

On September 10, 2015, in *Duignan v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Pinellas County, Fla., filed 2007), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $6 million in compensatory damages; found the decedent 33% at fault, RJR Tobacco 30% at fault, and the remaining defendant 37% at fault; and found that the plaintiff was entitled to punitive damages. On September 11, 2015, the jury awarded $2.5 million in punitive damages against RJR Tobacco and $3.5 million in punitive damages against the remaining defendant. The trial court later entered final judgment against RJR Tobacco and the remaining defendant in the amount of $6 million in compensatory damages and $2.5 million in punitive damages against RJR Tobacco and $3.5 million in punitive damages against the remaining defendant. The defendants appealed to the Second DCA, and RJR Tobacco posted a supersedeas bond in the amount of approximately $2.3 million. Oral argument occurred on December 5, 2016. A decision is pending.

On September 10, 2015, in *O'Hara v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Escambia County, Fla., filed 2007), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $14.7 million in compensatory damages; found the decedent 15% at fault and RJR Tobacco 85% at fault; and found that the plaintiff was entitled to punitive damages. On September 11, 2015, the jury awarded $20 million in punitive damages. In September 2015, the trial court entered final judgment against RJR Tobacco in the amount of $14.7 million in compensatory damages and $20 million in punitive damages. RJR Tobacco appealed to the First DCA and posted a supersedeas bond in the amount of $5 million. Briefing is complete. Oral argument has not been scheduled.

On September 22, 2015, in *Suarez v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Miami-Dade County, Fla., filed 2008), a jury found that the decedent was not a class member, which resulted in a verdict for the defendants, including RJR Tobacco. In November 2015, the trial court entered final judgment. The plaintiff appealed to the Third DCA, and the defendants cross appealed. On October 19, 2016, the Third DCA affirmed the judgment of the trial court, *per curiam*. On October 27, 2016, the plaintiff filed a motion for a written opinion and certification to the Florida Supreme Court. A decision is pending.

On October 2, 2015, in *Marchese v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Broward County, Fla., filed 2007), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $1 million in compensatory damages; found the decedent 55% at fault, RJR Tobacco 22.5% at fault, and the remaining defendant 22.5% at fault; and found that the plaintiff was entitled to punitive damages. On October 6, 2015, the jury awarded $250,000 in punitive damages against each defendant. Final judgment was entered on November 5,

2015. On May 17, 2016, an amended final judgment was entered in the amount of $450,000 in compensatory damages against RJR Tobacco and the remaining defendant, jointly and severally, and $250,000 in punitive damages against each defendant. RJR Tobacco appealed to the Fourth DCA and posted a supersedeas bond in the amount of $475,000. Briefing is underway.

On November 17, 2015, in *Barbose v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Pasco County, Fla., filed 2007), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $10 million in compensatory damages, found the decedent 15% at fault, RJR Tobacco 42.5% at fault and the remaining defendant 42.5% at fault; and found that the plaintiff was entitled to punitive damages. On November 18, 2015, the jury awarded $500,000 in punitive damages against each of RJR Tobacco and the other defendant. The defendants appealed to the Second DCA, and RJR Tobacco posted a supersedeas bond in the amount of $2.5 million. Briefing is complete. Oral argument has not been scheduled.

On November 20, 2015, in *Fanali v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Palm Beach County, Fla., filed 2008), a jury found that cigarette smoking was not a legal cause of the decedent’s coronary artery disease and death, which resulted in a verdict for RJR Tobacco. On December 17, 2015, the trial court entered final judgment in favor of RJR Tobacco. The plaintiff appealed to the Fourth DCA, and RJR Tobacco cross appealed. Briefing is complete. Oral argument has not been scheduled.

On November 23, 2015, in *Shulman v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Palm Beach County, Fla., filed 2007), a jury found that the plaintiff was not a class member, which resulted in a verdict for the defendants, including RJR Tobacco. In December 2015, the trial court entered final judgment. The plaintiff appealed to the Fourth DCA, and the defendants cross appealed. On August 11, 2016, the Fourth DCA affirmed the final judgment, *per curiam*. The plaintiff did not seek further review.

On November 24, 2015, in *Green v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Miami-Dade County, Fla., filed 2007), a jury found that the plaintiff does not have chronic obstructive pulmonary disease, which resulted in a verdict for RJR Tobacco. Post-trial motions were denied on March 23, 2016. On April 4, 2016, final judgment was entered in favor of RJR Tobacco. The plaintiff appealed to the Third DCA, and RJR Tobacco cross appealed. Briefing is underway.

On December 9, 2015, in *Monroe v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Gadsden County, Fla., filed 2007), a jury found for the plaintiff on the negligence and strict liability claims and for RJR Tobacco on the intentional tort claims, awarded $11 million in compensatory damages, found the plaintiff 42% at fault and RJR Tobacco 58% at fault, and did not reach the issue of entitlement to punitive damages. On December 31, 2015, the trial court entered final judgment against RJR Tobacco in the amount of $6.38 million in compensatory damages. Post-trial motions were denied on March 30, 2016. RJR Tobacco appealed to the First DCA and posted a supersedeas bond in the amount of $5 million. Oral argument is scheduled for March 7, 2017.

On December 18, 2015, in *Ledoux v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Miami-Dade County, Fla., filed 2007), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $10 million in compensatory damages; found the decedent 6% at fault, RJR Tobacco 47% at fault and the remaining defendant 47% at fault; and found that the plaintiff was entitled to punitive damages. On December 22, 2015, the jury awarded $12.5 million in punitive damages against each defendant. The trial court later entered final judgment against the defendants, jointly and severally, in the amount of $10 million in compensatory damages and, against each defendant, $12.5 million in punitive damages. Post-trial motions were denied in February 2016. The defendants appealed to the Third DCA, and RJR Tobacco posted a supersedeas bond in the amount of $5 million. On May 27, 2016, RJR Tobacco filed a rider amending the supersedeas bond reducing the amount from $5 million to $2.5 million. Briefing is underway.

On January 26, 2016, in *Ewing v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Escambia County, Fla., filed 2008), a jury found for the plaintiff on the negligence and strict liability claims and for the defendants on the intentional tort claims; awarded $240,000 in compensatory damages; found the decedent 98% at fault, RJR Tobacco 2% at fault and the remaining defendant 0% at fault, and did not reach the issue of entitlement to punitive damages. Post-trial motions were denied on February 25, 2016. Final judgment has not been entered.

On February 12, 2016, in *Ahrens v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Pinellas County, Fla., filed 2008), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $9 million in compensatory damages; found the decedent 32% at fault, RJR Tobacco 44% at fault, and the remaining defendant 24% at fault; and found that the plaintiff was entitled to punitive damages. On February 13, 2016, the jury awarded $2.5 million in punitive damages against each defendant. In February 2016, the trial court entered final judgment. Post-trial motions were denied on March 31, 2016. On April 13, 2016, RJR Tobacco appealed to the Second DCA and posted a supersedeas bond in the amount of $2.5 million. Briefing is complete. Oral argument has not been scheduled.

On March 8, 2016, in *Gamble v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Duval County, Fla., filed 2008), a jury found for the plaintiff on class membership, but found for RJR Tobacco on addiction causation, which resulted in a verdict for RJR Tobacco. Post-trial motions were denied on May 31, 2016. Final judgment was entered in favor of RJR Tobacco on June 9, 2016. The plaintiff appealed to the First DCA on July 8, 2016. Briefing is underway.

On April 7, 2016, in *Davis v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Miami-Dade County, Fla., filed 2008), a jury found for the plaintiff on class membership, but found for RJR Tobacco on addiction causation, which resulted in a verdict for RJR Tobacco. On August 17, 2016, the court granted the plaintiff's motion for a new trial. RJR Tobacco filed a notice of appeal to the Third DCA on August 25, 2016. Briefing is underway.

On April 21, 2016, in *Turner v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Broward County, Fla., filed 2007), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $3 million in compensatory damages; found the decedent 20% at fault and RJR Tobacco 80% at fault; and found that the plaintiff was entitled to punitive damages. On April 22, 2016, the jury awarded $10 million in punitive damages. The court denied the defendant's post-trial motions and entered judgment against RJR Tobacco in the amount of $2.4 million in compensatory damages and $10 million in punitive damages. In July 2016, RJR Tobacco filed a notice of appeal to the Fourth DCA and posted a supersedeas bond in the amount of $5 million. The plaintiff filed a notice of cross appeal in August 2016. Briefing is underway.

On April 26, 2016, in *Enochs v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Palm Beach County, Fla., filed 2007), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $21 million in compensatory damages; found the decedent 22% at fault, RJR Tobacco 66% at fault and the remaining defendant 12% at fault; and found that the plaintiff was entitled to punitive damages. On April 27, 2016, the jury awarded $6.25 million in punitive damages against each defendant. Final judgment was entered against RJR Tobacco in the amount of approximately $13.9 million in compensatory damages and $6.25 million in punitive damages on May 9, 2016. Post-trial motions were denied on May 20, 2016. The defendants appealed to the Fourth DCA, and RJR Tobacco posted a supersedeas bond in the amount of approximately $3.5 million. Briefing is underway.

On May 11, 2016, in *Dion v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Sarasota County, Fla., filed 2007), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $12 million in compensatory damages; found the decedent 25% at fault and RJR Tobacco 75% at fault; and found that the plaintiff was entitled to punitive damages. On May 12, 2016, the jury awarded $30,000 in punitive damages. Post-trial motions were denied on July 14, 2016. On August 9, 2016, RJR Tobacco filed a notice of appeal to the Second DCA and posted a supersedeas bond in the amount of $5 million. Briefing is underway.

On May 16, 2016, in *Nally v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Polk County, Fla., filed 2007), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $6 million in compensatory damages; found the decedent 25% at fault and RJR Tobacco 75% at fault; and found that the plaintiff was entitled to punitive damages. On May 17, 2016, the jury awarded $12 million in punitive damages. Final judgment was entered against RJR Tobacco in the amount of $6 million in compensatory damages and $12 million in punitive damages on May 25, 2016. Post-trial motions were denied on August 15, 2016. In September 2016, RJR Tobacco filed a notice of appeal to the Second DCA and posted a supersedeas bond in the amount of $5 million. Briefing is underway.

On May 19, 2016, in *McCabe v. R. J. Reynolds Tobacco Co*. (Cir. Ct. Hillsborough County, Fla., filed 2007), a jury found for the plaintiff on the negligence and strict liability claims, awarded $5 million in compensatory damages, found the decedent 70% at fault and RJR Tobacco 30% at fault, and found that the plaintiff was entitled to punitive damages. On May 20, 2016, the jury awarded $6.5 million in punitive damages. Post-trial motions are pending.

On May 31, 2016, in *Durrance v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Highlands County, Fla., filed 2007), the court declared a mistrial due to a medical emergency. Retrial began on January 23, 2017.

On June 21, 2016, in *Mooney v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Miami-Dade County, Fla., filed 2008), a jury found that the decedent's addiction to nicotine was not a legal cause of her death, which resulted in a verdict for the defendants, including RJR Tobacco. The plaintiff's post-trial motions were denied on November 4, 2016.

On July 1, 2016, in *Sermons v. Philip Morris USA Inc.* (Cir. Ct. Duval County, Fla., filed 2008), a jury found for the plaintiff on the negligence and strict liability claims; awarded $65,000 in compensatory damages; found the decedent 80% at fault, RJR Tobacco 5% at fault, and the remaining defendant 15% at fault; and found that the plaintiff was entitled to punitive damages. On July 6, 2016, the jury awarded $17,075 in punitive damages against RJR Tobacco and $51,225 in punitive damages against the remaining defendant. Post-trial motions are pending.

On July 19, 2016, in *Varner v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Broward County, Fla., filed 2007), a jury found for the plaintiff on the negligence and strict liability claims; found that RJR Tobacco's cigarettes were not a legal cause of the decedent's disease, which resulted in a verdict for RJR Tobacco; awarded $1.5 million in compensatory damages; found the decedent 75% at fault and the remaining defendant 25% at fault; and found that the plaintiff was not entitled to punitive damages. Final judgment was entered in favor of RJR Tobacco and against the remaining defendant in the amount of $375,000 in July 2016. The remaining defendant's post-trial motions were denied on December 21, 2016.

On August 5, 2016, in *Morales v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Miami-Dade County, Fla., filed 2007), the court declared a mistrial because a death in a juror's family prevented the juror from deliberating. The new trial was scheduled for January 9, 2017, but has since been removed from the trial calendar.

On August 15, 2016, in *Mathis v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Miami-Dade County, Fla., filed 2007), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $5 million in compensatory damages; found the decedent 45% at fault and RJR Tobacco 55% at fault; and found that the plaintiff was not entitled to punitive damages. Final judgment was entered on August 17, 2016. Post-trial motions were denied on October 24, 2016. RJR Tobacco filed a notice of appeal to the Third DCA and posted a supersedeas bond in the amount of $5 million on November 18, 2016. Briefing is underway.

On August 18, 2016, in *Wilkins v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Miami-Dade County, Fla., filed 2007), a jury found that the decedent was not a class member, which resulted in a verdict for RJR Tobacco. Final judgment was entered in favor of RJR Tobacco on November 16, 2016. The plaintiff filed a notice of appeal to the Third DCA on December 16, 2016, and RJR Tobacco filed a notice of cross appeal on December 21, 2016. Briefing is underway.

On August 25, 2016, in *Coursey v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Volusia County, Fla., filed 2007), a jury found that the decedent was not a class member, which resulted in a verdict for RJR Tobacco. The trial court denied post-trial motions and entered judgment in RJR Tobacco's favor on September 27, 2016. On October 27, 2016, the plaintiff filed a notice of appeal to the Fifth DCA. RJR Tobacco filed a notice of cross appeal on November 8, 2016. Briefing is underway.

On September 6, 2016, in *Hackimer v. R. J. Reynolds Tobacco Co*. (Cir. Ct. Palm Beach County, Fla., filed 2007), a jury found that the deceased smoker knew or should have known of his chronic obstructive pulmonary disease before May 5, 1990, and, for that reason, the claims were barred by the statute of limitations, which resulted in a verdict for RJR Tobacco. Post-trial motions were denied on December 20, 2016. On January 4, 2017, final judgment was entered in favor of RJR Tobacco. The plaintiff filed a notice of appeal to the Fourth DCA on February 1, 2017. Briefing is underway.

On September 22, 2016, in *Oshinsky-Blacker v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Broward County, Fla., filed 2007), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $6.15 million in compensatory damages; found the decedent 15% at fault, RJR Tobacco 25% at fault, and the remaining defendant 60% at fault; and found that the plaintiff was entitled to punitive damages. On September 23, 2016, the jury awarded $2 million in punitive damages against RJR Tobacco and $1 million in punitive damages against the remaining defendant. Post-trial motions are pending. Final judgment has not been entered.

On September 23, 2016, in *Sherry Smith v. R. J. Reynolds Tobacco Co*. (Cir. Ct. Volusia County, Fla., filed 2008), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $3 million in compensatory damages; found the decedent 35% at fault and RJR Tobacco 65% at fault; and found that the plaintiff was not entitled to punitive damages. Post-trial motions were denied on December 14, 2016, and final judgment was entered against RJR Tobacco in the amount of $3 million. In January 2017, RJR Tobacco filed a notice of appeal to the Fifth DCA and posted a supersedeas bond in the amount of $3 million. Briefing is underway.

On September 28, 2016, in *Prentice v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Duval County, Fla., filed 2007), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $6.4 million in compensatory damages; found the decedent 60% at fault and RJR Tobacco 40% at fault; and found that the plaintiff was entitled to punitive damages. On September 29, 2016, the jury awarded $0 in punitive damages. Post-trial motions are pending.

On October 10, 2016, in *Wallace v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Brevard County, Fla., filed 2007), the court declared a mistrial due to weather delays and juror unavailability. A new trial date has not been scheduled.

On October 24, 2016, in *Konzelman v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Broward County, Fla., filed 2007), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded approximately $8.8 million in compensatory damages; found the decedent 15% at fault and RJR Tobacco 85% at fault; and found that the plaintiff was entitled to punitive damages. On October 26, 2016, the jury awarded $20 million in punitive damages. On December 1, 2016, post-trial motions were denied and the trial court entered final judgment against RJR Tobacco in the amount of approximately $7.48 million in compensatory damages and $20 million in punitive damages. RJR Tobacco filed a notice of appeal to the Fourth DCA and posted a supersedeas bond in the amount of $5 million on December 22, 2016. The plaintiff filed a notice of cross appeal on January 2, 2017. Briefing is underway.

On November 1, 2016, in *Maloney v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Lee County, Fla., filed 2007), the court declared a mistrial due to the jury's inability to reach a unanimous verdict. The new trial is scheduled for July 5, 2017.

On November 2, 2016, in *Johnston v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Sarasota County, Fla., filed 2007), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded $7.5 million in compensatory damages; found the decedent 10% at fault and RJR Tobacco 90% at fault; and found that the plaintiff was entitled to punitive damages. On November 5, 2016, the jury awarded $14 million in punitive damages. Final judgment was entered against RJR Tobacco in the amount of $6.75 million in compensatory damages and $14 million in punitive damages on November 28, 2016. Post-trial motions are pending.

On November 3, 2016, in *Ledo v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Miami-Dade County, Fla., filed 2008), a jury found for the plaintiff on the negligence and strict liability claims and for RJR Tobacco on the intentional tort claims; awarded $6 million in compensatory damages; found the decedent 51% at fault and RJR Tobacco 49% at fault; and found that the plaintiff was entitled to punitive damages. After receiving the verdict, the trial court granted a directed verdict in favor of RJR Tobacco on entitlement to punitive damages. Final judgment was entered against RJR Tobacco in the amount of $2.94 million in compensatory damages on December 22, 2016. Post-trial motions are pending.

On November 10, 2016, in *Howles v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Broward County, Fla., filed 2007), a jury found for the plaintiff on the negligence, strict liability and intentional tort claims; awarded $4 million in compensatory damages; found RJR Tobacco 50% at fault and the remaining defendant 50% at fault; and found that the plaintiff was entitled to punitive damages. On November 14, 2016, the jury awarded $3 million in punitive damages against RJR Tobacco and $3 million against the remaining defendant. Final judgment was entered against RJR Tobacco in the amount of $2 million in compensatory damages and $3 million in punitive damages against RJR Tobacco. Post-trial motions were denied on December 5, 2016. On December 30, 2016, the defendants filed a joint notice of appeal to the Fourth DCA. Briefing is underway.

On November 14, 2016, in *Kloppenburg v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Collier County, Fla., filed 2007), a jury found that the plaintiff knew or should have known of her chronic obstructive pulmonary disease before May 5, 1990, and, for that reason, the claims were barred by the statute of limitations, which resulted in a verdict for RJR Tobacco. Final judgment was entered in favor of RJR Tobacco on November 29, 2016. The plaintiff's post-trial motions were denied on December 1, 2016. The plaintiff did not seek further review.

On November 16, 2016, in *Ford v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Palm Beach County, Fla., filed 2008), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded approximately $1.02 million in compensatory damages; found the plaintiff 85% at fault and RJR Tobacco 15% at fault; and found that the plaintiff was not entitled to punitive damages. Post-trial motions are pending.

On November 16, 2016, in *Stanley Martin v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Broward County, Fla., filed 2007), a jury found for the plaintiff on the negligence, strict liability, and intentional tort claims; awarded approximately $5.41 million in compensatory damages; found the decedent 32% at fault, RJR Tobacco 22% at fault and the remaining defendant 46% at fault; and found that the plaintiff was entitled to punitive damages. On November 18, 2016, the jury awarded $200,000 in punitive damages against RJR Tobacco and $450,000 against the remaining defendant. Post-trial motions are pending.

On December 16, 2016, in *Dubinsky v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Brevard County, Fla., filed 2008), a jury found that the decedent was not a class member, which resulted in a verdict for the defendants, including RJR Tobacco. Post-trial motions are pending.

On December 16, 2016, in *Pardue v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Alachua County, Fla., filed 2008), a jury, in a retrial following a mistrial, found for the plaintiff on the negligence, strict liability, and

intentional tort claims; awarded approximately $5.9 million in compensatory damages; found the decedent 25% at fault, RJR Tobacco 50% at fault, and the remaining defendant 25% at fault; and found that the plaintiff was entitled to punitive damages. On December 19, 2016, the jury awarded $6.75 million in punitive damages against RJR Tobacco and $6.75 million in punitive damages against the remaining defendant. Final judgment was entered against RJR Tobacco in the amount of approximately $5.9 million in compensatory damages (jointly and severally with the remaining defendant) and, against each defendant, $6.75 million in punitive damages on December 29, 2016. Post-trial motions are pending.

Broin II Cases

Broin v. Philip Morris, Inc. (Cir. Ct. Miami-Dade County, Fla., filed 1991), was a class action brought on behalf of flight attendants alleged to have suffered from diseases or ailments caused by exposure to ETS in airplane cabins. In October 1997, RJR Tobacco, Lorillard Tobacco, B&W and other cigarette manufacturer defendants settled *Broin* , agreeing to pay a total of $300 million in three annual $100 million installments, allocated among the companies by market share, to fund research on the early detection and cure of diseases associated with tobacco smoke. It also required those companies to pay a total of $49 million for the plaintiffs' counsel's fees and expenses. RJR Tobacco's portion of these payments was approximately $86 million; Lorillard Tobacco's was approximately $57 million; and B&W's was approximately $31 million. The settlement agreement, among other things, limits the types of claims class members may bring and eliminates claims for punitive damages. The settlement agreement also provides that, in individual cases by class members that are referred to as *Broin II* lawsuits, the defendant will bear the burden of proof with respect to whether ETS can cause certain specifically enumerated diseases, referred to as "general causation." With respect to all other liability issues, including whether an individual plaintiff's disease was caused by his or her exposure to ETS in airplane cabins, referred to as "specific causation," individual plaintiffs will bear the burden of proof. On September 7, 1999, the Florida Supreme Court approved the settlement.

As of December 31, 2016, there were 2,406 *Broin II* lawsuits pending in Florida. There have been no *Broin II* trials since 2007.

Class-Action Suits

Overview. As of December 31, 2016, 25 class-action cases, excluding the shareholder case described below, were pending in the United States against Reynolds Defendants. These class actions seek recovery for personal injuries allegedly caused by cigarette smoking or, in some cases, for economic damages allegedly incurred by cigarette or e-cigarette purchasers.

In 1996, the Fifth Circuit Court of Appeals in *Castano v. American Tobacco Co.* overturned the certification of a nation-wide class of persons whose claims related to alleged addiction to tobacco products, finding that the district court failed to properly assess variations in the governing state laws and whether common issues predominated over individual issues. Since the Fifth Circuit's ruling in *Castano*, few smoker class-action complaints have been certified or, if certified, have survived on appeal. Eighteen federal courts, including two courts of appeals, and most state courts that have considered the issue have rejected class certification in such cases. Apart from *Castano*, only two smoker class actions have been certified by a federal court — *In re Simon (II) Litigation* and *Schwab [McLaughlin] v. Philip Morris USA Inc.*, both of which were filed in the U.S. District Court for the Eastern District of New York and were later decertified.

Class-action suits based on claims that class members are at a greater risk of injury or injured by the use of tobacco or exposure to ETS, or claims that seek primarily economic damages are pending against RJR Tobacco, Lorillard Tobacco, or their affiliates or indemnitees in state or federal courts in California, Florida, Illinois, Louisiana, Missouri, New Mexico, New York, North Carolina and West Virginia. All pending class-action cases are discussed below.

The pending class actions against RJR Tobacco or its affiliates or indemnitees include four cases alleging that the use of the term "lights" constitutes unfair and deceptive trade practices under state law or violates federal RICO. Such suits are pending in state courts in Illinois and Missouri and are discussed below under "— 'Lights' Cases."

E-cigarette class-action cases are pending against RJR Vapor, RAI, and other RAI affiliates in California state and federal courts. In general, the plaintiffs allege that RJR Vapor, Lorillard Tobacco, and other RAI affiliates made false and misleading claims that e-cigarettes are less hazardous than other cigarette products or failed to disclose that e-cigarettes expose users to certain substances. The cases are typically filed pursuant to state consumer protection and related statutes and seek recovery of economic damages and are discussed below under "— E-Cigarette Cases."

Several class actions relating to claims in advertising and promotional materials for SFNTC's NATURAL AMERICAN SPIRIT brand cigarettes are pending in federal courts. In general, these plaintiffs allege that use of the words "natural," "additive-free," or "organic" in NATURAL AMERICAN SPIRIT advertising and promotional materials suggests that those cigarettes are less harmful than other cigarettes and, for that reason, violated state consumer protection statutes or amounted to fraud or a negligent or intentional misrepresentation. These cases are discussed below under "— No Additive/Natural Claim Cases."

Additional class actions relating to alleged personal injuries purportedly caused by use of cigarettes or exposure to ETS are pending. These cases are discussed below under "— Other Class Actions."

Finally, certain third-party payers have filed health-care cost recovery actions in the form of class actions. These cases are discussed separately below under "— Health-Care Cost Recovery Cases."

"*Lights*" *Cases.*

As noted above, four "lights" class-action cases are pending against RJR Tobacco or B&W, two in Illinois state court and two in Missouri state court. The classes in these cases generally seek to recover compensatory and punitive damages, injunctive and other forms of relief, and attorneys' fees and costs from RJR Tobacco and/or B&W. In general, the plaintiffs allege that RJR Tobacco or B&W made false and misleading claims that "lights" cigarettes were lower in tar and nicotine and/or were less hazardous or less mutagenic than other cigarettes. The cases typically are filed pursuant to state consumer protection and related statutes.

The seminal "lights" class-action case is *Price v. Philip Morris, Inc*. (Cir. Ct. Madison County, Ill., filed 2000), an action filed against the predecessor of Philip Morris USA Inc., referred to as Philip Morris. In March 2003, the trial court entered judgment against Philip Morris in the amount of $7.1 billion in compensatory damages and $3 billion in punitive damages. In December 2005, the Illinois Supreme Court issued an opinion reversing and remanding with instructions to dismiss the case. On December 5, 2006, the Illinois Supreme Court issued its mandate, and the trial court entered a judgment of dismissal later in December 2006. In multiple filings since December 2008, the *Price* plaintiffs have argued that the U.S. Supreme Court's decision in *Good v. Altria Group, Inc*. rejected the basis upon which the Illinois Supreme Court had reversed the *Price* trial court's 2003 judgment and, on that basis, have attempted to reinstate that judgment. In April 2014, the intermediate appellate court reinstated the trial court's 2003 judgment. In November 2015, the Illinois Supreme Court (1) vacated the lower courts' judgments, (2) dismissed the case without prejudice to allow the plaintiffs to file a motion to have the Illinois Supreme Court recall its December 5, 2006, mandate that had reversed the trial court's 2003 judgment, and (3) directed entry of a judgment of dismissal. The plaintiffs then moved in the Illinois Supreme Court to have that court recall its December 5, 2006 mandate. On January 11, 2016, the Illinois Supreme Court denied the plaintiffs' motion. The plaintiffs filed a petition for writ of certiorari with the U.S. Supreme Court on January 22, 2016, which was denied on June 20, 2016.

In *Turner v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Madison County, Ill., filed 2000), the trial court certified a class of purchasers of RJR Tobacco "lights" cigarettes in November 2001. In November 2003, the Illinois Supreme Court granted RJR Tobacco's motion for a stay pending the court's final appeal decision in the *Price* case described above. The stay subsequently expired, and the court accordingly scheduled a series of status conferences, all of which were continued by agreement of the parties. The next status conference is scheduled for February 22, 2017.

In *Howard v. Brown & Williamson Tobacco Corp.* (Cir. Ct. Madison County, Ill., filed 2000), the trial court certified a class of purchasers of B&W "lights" cigarettes in December 2001. In June 2003, the trial judge issued an order staying all proceedings pending resolution of the *Price* case described above. In August 2005, the Illinois Fifth District Court of Appeals affirmed the Circuit Court's stay order. There is currently no activity in the case.

In *Collora v. R. J. Reynolds Tobacco Co.* (Cir. Ct. City of St. Louis, Mo., filed 2000), the trial court certified a class of purchasers of RJR Tobacco "lights" cigarettes in December 2003. A status conference is scheduled for June 5, 2017.

In *Black v. Brown & Williamson Tobacco Corp.* (Cir. Ct. City of St. Louis, Mo., filed 2000), a putative class action filed on behalf of a class of purchasers of B&W "lights" cigarettes, a status conference is scheduled for June 5, 2017.

In the event RJR Tobacco and its affiliates or indemnitees lose one or more of the pending "lights" class-action suits, RJR Tobacco, depending upon the amount of any damages ordered, could face difficulties in its ability to pay the judgment or obtain any bond required to stay execution of the judgment which could have a material adverse effect on RJR Tobacco's, and consequently RAI's, results of operations, cash flows or financial position.

E-Cigarette Cases.

In *In re Fontem US, Inc. Consumer Class Action Litig.* (U.S.D.C. C.D. Cal., filed 2015), the plaintiffs brought a class action against RAI, Lorillard, another RAI affiliate, and two other defendants on behalf of putative classes of California, New York, and Illinois purchasers of blu brand e-cigarettes. This action results from the consolidation of two actions — *Diek v. Lorillard Tobacco Co.* and *Whitney v. ITG Brands, LLC.* The plaintiffs allege that certain advertising, marketing and packaging materials for blu brand e-cigarettes made deceptive claims, omitted material information, or failed to contain required disclosures. On behalf of one or more of the classes, the plaintiffs seek injunctive relief, equitable relief, and compensatory and punitive damages under California Civil Code §1,750 *et seq*., California Business & Professions Code §17,200 *et seq*., California Business and Professions Code §17,500 *et seq*., New York General Business Law § 349, and Illinois Consumer Fraud And Deceptive Business Practices Act § 505/1 *et seq.* Pursuant to the terms of the asset purchase agreement relating to the Divestiture, RAI tendered the defense of the now-consolidated *Diek* and *Whitney* actions to, and sought indemnification for those actions from, ITG. Pursuant to the terms, limitations and conditions of the asset purchase agreement relating to the Divestiture, ITG agreed to defend and indemnify RAI and its affiliates against losses arising from the operation of the blu brand e-cigarette business. On May 20, 2016, the trial court stayed the matter pending the Ninth Circuit Court of Appeals' rulings in *Briseno v. ConAgra Foods, Inc.* (decided January 3, 2017), *Jones v. ConAgra Foods, Inc.* (pending), and *Brazil v. Dole Packaged Foods, LLC* (decided September 30, 2016). The stay did not apply to finalizing the pleadings and related briefing. On May 23, 2016, the plaintiffs filed a second amended consolidated complaint, which the defendants moved to dismiss. On November 1, 2016, the trial court granted the defendants' motion to dismiss in substantial part, finding that federal law preempted all of the plaintiffs' claims except those based on alleged violations of California's Proposition 65 under California's Business and Professions Code §17,200 *et seq*. On November 21, 2016, the plaintiffs moved for reconsideration of the trial court's November 1, 2016 order. The trial court scheduled a hearing on the plaintiffs' motion for reconsideration for February 13, 2017.

In *Harris v. R. J. Reynolds Vapor Co.* (U.S.D.C. N.D. Cal., filed 2015), the plaintiff brought a class action against RJR Vapor on behalf of a putative class of purchasers of VUSE e-cigarettes. The plaintiff alleges that RJR Vapor failed to advise users that they potentially could be exposed to formaldehyde and acetaldehyde. The plaintiff asserts failure to warn claims under California's Proposition 65, as well as California Business & Professions Code § 17,200 *et seq* . and California Civil Code § 1,750 *et seq*. and seeks declaratory relief, restitution, disgorgement, injunctive relief and damages. RJR Vapor moved to dismiss contending, among other things, that plaintiff's action was governed in its entirety by Proposition 65 and that the plaintiff failed to give the 60-day pre-suit notice required by Proposition 65, requiring that the entire case be dismissed with prejudice. The motion to dismiss was argued on March 2, 2016. On September 30, 2016, the court granted RJR Vapor's motion to dismiss but provided the plaintiff leave to amend. The plaintiff filed a second amended complaint on October 31, 2016, and RJR Vapor has again moved to dismiss. Oral argument occurred on January 19, 2017. A decision is pending.

In *Center for Environmental Health v. NJoy, Inc.* (Super. Ct. Alameda County, Cal., filed 2015), the plaintiff brought an action against RJR Vapor and several other e-cigarette manufacturers asserting violations of Proposition 65 for not disclosing that electronic cigarettes, including VUSE, allegedly expose consumers to formaldehyde and acetaldehyde. The plaintiff sought civil penalties, injunctive relief, attorneys' fees, and costs. RJR Vapor filed an answer on December 29, 2015. RJR Vapor denied any and all liability and reached an agreement to resolve the claims for $94,750. The court approved the settlement agreement on October 25, 2016.

No Additive/Natural/Organic Claim Cases.

Following the FDA's August 27, 2015, warning letter to SFNTC relating to the use of the words "natural" and "additive-free" in the labeling, advertising and promotional materials for NATURAL AMERICAN SPIRIT brand cigarettes, plaintiffs purporting to bring claims on behalf of themselves and others have filed putative nationwide and/or state-specific class actions against SFNTC and, in some instances, RAI. A total of 16 such actions have been filed in nine U.S. district courts. Each of these cases is discussed below. In various combinations, plaintiffs in these cases generally allege violations of state deceptive and unfair trade practice statutes, and claim state common law fraud, negligent misrepresentation, and unjust enrichment based on the use of descriptors such as "natural," "organic" and "100% additive-free" in the marketing, labeling, advertising, and promotion of SFNTC's NATURAL AMERICAN SPIRIT brand cigarettes. The actions seek various categories of recovery, including economic damages, injunctive relief (including medical monitoring and cessation programs), interest, restitution, disgorgement, treble and punitive damages, and attorneys' fees and costs.

On January 6, 2016, the plaintiffs in one action filed a motion before the U.S. Judicial Panel on Multidistrict Litigation ("JPML") to consolidate these actions before one district court for pretrial purposes. On April 11, 2016, the JPML ordered that these cases be consolidated for pretrial purposes before Judge James O. Browning in the U.S. District Court for the District of New Mexico, referred to as the transferee court, and the then-pending and later-filed cases now are consolidated for pretrial purposes in that court. The cases that were filed in or transferred for pretrial purposes to the transferee court are as follows:

- *Sproule v. Santa Fe Natural Tobacco Co., Inc*. (U.S.D.C. S.D. Fla., filed 2015), is an action against SFNTC and RAI on behalf of a putative nationwide class of purchasers of NATURAL AMERICAN SPIRIT brand cigarettes.
- *Brattain v. Santa Fe Natural Tobacco Co., Inc.* (U.S.D.C. N.D. Cal., filed 2015), is an action against SFNTC and RAI on behalf of a putative class of California purchasers of NATURAL AMERICAN SPIRIT brand cigarettes.
- *Rothman v. Santa Fe Natural Tobacco Co., Inc.* (U.S.D.C. S.D.N.Y., filed 2015), is an action against SFNTC and RAI on behalf of a putative class of New York purchasers of NATURAL AMERICAN SPIRIT brand cigarettes.
- *Dunn v. Santa Fe Natural Tobacco Co., Inc.* (U.S.D.C. D.N.M., filed 2015), is an action against SFNTC on behalf of a putative nationwide class (and Minnesota subclass) of purchasers of NATURAL AMERICAN SPIRIT brand cigarettes.
- *Haksal v. Santa Fe Natural Tobacco Co., Inc.* (U.S.D.C. D.N.M., filed 2015), is an action against SFNTC and RAI on behalf of a putative nationwide class (and California, Illinois, Minnesota, and New Mexico subclasses) of purchasers of NATURAL AMERICAN SPIRIT brand cigarettes.
- *Cuebas v. Santa Fe Natural Tobacco Co., Inc.* (U.S.D.C. S.D.N.Y., filed 2016), is an action against SFNTC and RAI on behalf of a putative nationwide class (and New York subclass) of purchasers of NATURAL AMERICAN SPIRIT brand cigarettes.
- *Okstad v. Santa Fe Natural Tobacco Co., Inc.* (U.S.D.C. M.D. Fla., filed 2016), is an action against SFNTC and RAI on behalf of a putative nationwide class and sixteen putative state-based subclasses (Alabama, California, Colorado, Florida, Georgia, Iowa, Illinois, Maryland, Maine, North Carolina, New Jersey, Ohio, Oregon, Pennsylvania, Texas and Wisconsin subclasses) of purchasers of NATURAL AMERICAN SPIRIT brand cigarettes.
- *Ruggiero v. Santa Fe Natural Tobacco Co., Inc.* (U.S.D.C. D.D.C., filed 2016), is an action against SFNTC and RAI on behalf of a putative nationwide class (and Maryland subclass) of purchasers of NATURAL AMERICAN SPIRIT brand cigarettes.
- *Waldo v. Santa Fe Natural Tobacco Co., Inc.* (U.S.D.C. M.D. Fla., filed 2016), is an action against SFNTC and RAI on behalf of a putative nationwide class (and Florida subclass) of purchasers of NATURAL AMERICAN SPIRIT brand cigarettes.
- *Grandison v. Santa Fe Natural Tobacco Co., Inc.* (U.S.D.C. E.D.N.Y., filed 2016), is an action against SFNTC and RAI on behalf of a putative nationwide class (and California, Florida and New York subclasses) of purchasers of NATURAL AMERICAN SPIRIT brand cigarettes.
- *Gudmundson v. Santa Fe Natural Tobacco Co., Inc.* (U.S.D.C. V.I., filed 2016), is an action against SFNTC and RAI on behalf of a putative class of U.S. Virgin Islands purchasers of NATURAL AMERICAN SPIRIT brand cigarettes.
- *LeCompte v. Santa Fe Natural Tobacco Co., Inc.* (U.S.D.C. D.N.M., filed 2016), is an action against SFNTC and RAI on behalf of a putative class of California purchasers of NATURAL AMERICAN SPIRIT brand cigarettes.
- *White v. Santa Fe Natural Tobacco Co., Inc.* (U.S.D.C. D.N.M., filed 2016), is an action against SFNTC on behalf of a putative nationwide class of purchasers of NATURAL AMERICAN SPIRIT brand cigarettes.
- *Johnston v. Santa Fe Natural Tobacco Co., Inc.* (U.S.D.C. S.D Fla., filed 2016), is an action against SFNTC and RAI on behalf of a putative nationwide class (and Florida subclass) of purchasers of NATURAL AMERICAN SPIRIT brand cigarettes.
- *Cole v. Santa Fe Natural Tobacco Co., Inc.* (U.S.D.C. M.D. N.C., filed 2016), is an action against SFNTC and RAI on behalf of a putative nationwide class (and North Carolina subclass) of purchasers of NATURAL AMERICAN SPIRIT brand cigarettes.

- *Hebert v. Santa Fe Natural Tobacco Co., Inc.* (U.S.D.C. M.D. N.C., filed 2016), is an action against SFNTC, RAI and RJR Tobacco on behalf of a putative class of purchasers in California, Colorado, Florida, Illinois, Massachusetts, Michigan, New Jersey, New Mexico, New York, Ohio and Washington of NATURAL AMERICAN SPIRIT cigarettes, and a nationwide putative class of NATURAL AMERICAN SPIRIT brand menthol cigarette purchasers (and subclass of such purchasers in California, Colorado, Florida, Illinois and New Mexico).

The transferee court entered a scheduling order requiring the plaintiffs to file a consolidated amended complaint. On September 19, 2016, the plaintiffs filed a consolidated amended complaint naming SFNTC, RAI, and RJR Tobacco as defendants. That complaint alleges violations of 12 states' deceptive and unfair trade practices statutes — California, Colorado, Florida, Illinois, Massachusetts, Michigan, North Carolina, New Jersey, New Mexico, New York, Ohio, and West Virginia — based on the use of descriptors such as "natural," "organic" and "100% additive-free" in the marketing, labeling, advertising, and promotion of SFNTC's NATURAL AMERICAN SPIRIT brand cigarettes. It also asserts unjust enrichment claims under those 12 states' laws and asserts breach of express warranty claims on behalf of a national class of NATURAL AMERICAN SPIRIT menthol purchasers. The state deceptive and unfair trade practice statutory and unjust enrichment claims are brought on behalf of state-specific classes in the 12 states listed above and, in some instances, state-specific subclasses. The consolidated amended complaint seeks class certification, payment for class notice, injunctive relief, monetary damages, prejudgment interest, statutory damages, restitution, and attorneys' fees and costs. On November 18, 2016, the defendants filed a motion to dismiss, and a hearing on that motion is scheduled for March 22, 2017. On January 12, 2017, the plaintiffs filed a second consolidated amended class action complaint. The transferee court's scheduling order, as amended, provides for the plaintiffs to file a motion for class certification by April 3, 2018, and a hearing on the class certification motion on July 13-14, 2018.

On November 7, 2016, a public health advocacy organization filed *Breathe DC v. Santa Fe Natural Tobacco Co., Inc*. (D.C. Super. Ct.), an action against SFNTC, RAI and RJR Tobacco based on allegations relating to the labeling, advertising and promotional materials for NATURAL AMERICAN SPIRIT brand cigarettes that are similar to the allegations in the actions consolidated for pre-trial purposes in the U.S. District Court for the District of New Mexico transferee court described immediately above. The complaint seeks injunctive and other non-monetary relief, but does not seek monetary damages. On December 6, 2016, the defendants removed the action to the U.S. District Court for the District of Columbia and, on December 7, 2016, filed a notice with the JPML to have the action transferred to the transferee court. On December 7, 2016, the plaintiff moved in the U.S. District Court for the District of Columbia to remand the action to the Superior Court for the District of Columbia. On December 9, 2016, the JPML conditionally ordered that the case be transferred to the transferee court. On December 20, 2016, the U.S. District Court for the District of Columbia issued an order stating that it will rule on the plaintiff's motion to remand before the JPML considers the plaintiff's motion to vacate the conditional transfer order.

Other Class Actions.

In *Young v. American Tobacco Co., Inc.* (Cir. Ct. Orleans Parish, La., filed 1997), the plaintiff brought a class action against U.S. cigarette manufacturers, including RJR Tobacco and B&W, and parent companies of U.S. cigarette manufacturers, including RJR, on behalf of a putative class of Louisiana residents who, though not themselves cigarette smokers, allegedly suffered injury as a result of exposure to ETS from cigarettes manufactured by defendants. The plaintiffs seek to recover an unspecified amount of compensatory and punitive damages. In March 2016, the court entered an order staying the case, including all discovery, pending the completion of the smoking cessation program ordered by the court in *Scott v. The American Tobacco Co*.

In *Parsons v. A C & S, Inc.* (Cir. Ct. Ohio County, W. Va., filed 1998), the plaintiff brought a class action against asbestos manufacturers, U.S. cigarette manufacturers, including RJR Tobacco, B&W, Lorillard Tobacco, and parent companies of U.S. cigarette manufacturers, including RJR and Lorillard, on behalf of a putative class of persons who allegedly have personal injury claims arising from their exposure to respirable asbestos fibers and cigarette smoke. The plaintiff seeks to recover $1 million in compensatory and punitive damages individually for her purported injuries and an unspecified amount for the class in compensatory and punitive damages. In December 2000, three defendants, Nitral Liquidators, Inc., Desseaux Corporation of North America and Armstrong World Industries, filed bankruptcy petitions in the U.S. Bankruptcy Court for the District of Delaware, *In re Armstrong World Industries, Inc.* Pursuant to section 362(a) of the Bankruptcy Code, *Parsons* is automatically stayed with respect to all defendants who filed for bankruptcy. The case remains pending against the other defendants, including RJR Tobacco and Lorillard Tobacco, but it has long been dormant.

In *Jones v. American Tobacco Co., Inc.* (Cir. Ct., Jackson County, Mo., filed 1998), the plaintiff filed a class action against the major U.S. cigarette manufacturers, including RJR Tobacco, B&W, Lorillard Tobacco, and parent companies of U.S. cigarette manufacturers, including RJR and Lorillard, on behalf of a putative class of Missouri tobacco product users and purchasers who allegedly became addicted to nicotine. The plaintiffs seek an unspecified amount of compensatory and punitive damages. There is currently no activity in this case.

Filter Cases

Claims have been brought against Lorillard Tobacco and Lorillard by individuals who seek damages resulting from their alleged exposure to asbestos fibers that were incorporated into filter material used in one brand of cigarettes manufactured by a predecessor to Lorillard Tobacco for a limited period of time ending more than 50 years ago. As of December 31, 2016, Lorillard Tobacco and/or Lorillard was a defendant in 78 Filter Cases. Since January 1, 2013, Lorillard Tobacco and RJR Tobacco have paid, or have reached agreement to pay, a total of approximately $47.6 million in settlements to resolve 175 claims asserted in Filter Cases.

Pursuant to the terms of a 1952 agreement between P. Lorillard Company and H&V Specialties Co., Inc. (the manufacturer of the filter material), Lorillard Tobacco is required to indemnify Hollingsworth & Vose for legal fees, expenses, judgments and resolutions in cases and claims alleging injury from finished products sold by P. Lorillard Company that contained the filter material.

On September 13, 2013, the jury in a Filter Case, *DeLisle v. A. W. Chesterton Co.* (Cir. Ct. Broward County, Fla., filed 2012), found for the plaintiffs on the negligence and strict liability claims; awarded the plaintiffs $8 million in compensatory damages; and found Lorillard Tobacco 22% at fault, Hollingsworth & Vose 22% at fault, and the other defendants 56% at fault. Punitive damages were not at issue. On November 6, 2013, the trial court entered final judgment against Lorillard Tobacco in the amount of $3.52 million. Lorillard Tobacco appealed to the Fourth DCA. On September 14, 2016, the Fourth DCA ordered a new trial because the trial court erred in admitting certain expert testimony and concluded that the $8 million compensatory damages award should have been remitted. The plaintiffs filed a motion for rehearing or rehearing *en banc,* which was denied by the Fourth DCA on November 9, 2016. The plaintiffs filed an application for discretionary review by the Florida Supreme Court on December 6, 2016. The Florida Supreme Court has issued a stay of the proceedings in that court pending its disposition of a pending application for review in another case. The matter has not been stayed in the trial court, and post-appeal motions are pending to vacate the final judgment and discharge the surety bonds. The plaintiffs have filed both a stay motion in the Florida Supreme Court and a motion to recall the mandate in the Fourth DCA, which motions are presently pending.

Health-Care Cost Recovery Cases

Health-care cost recovery cases have been brought by a variety of plaintiffs. Other than certain governmental actions, these cases largely have been unsuccessful on remoteness grounds, which means that one who pays an injured person's medical expenses is legally too remote to maintain an action against the person allegedly responsible for the injury.

As of December 31, 2016, two health-care cost recovery cases were pending in the United States against RJR Tobacco, B&W, Lorillard Tobacco, or all three, as discussed below after the discussion of the State Settlement Agreements. A limited number of claimants have filed suit against RJR Tobacco, one of its affiliates, and other tobacco industry defendants to recover funds for health care, medical and other assistance paid by foreign provincial governments in treating their citizens. For additional information on these cases, see "— International Cases" below.

State Settlement Agreements. In June 1994, the Mississippi Attorney General brought an action, *Moore v. American Tobacco Co.* , against various industry members, including RJR Tobacco, B&W and Lorillard Tobacco. This case was brought on behalf of the state to recover state funds paid for health care and other assistance to state citizens suffering from diseases and conditions allegedly related to tobacco use. Most other states, through their attorneys general or other state agencies, sued RJR Tobacco, B&W, Lorillard Tobacco and other U.S. cigarette manufacturers based on similar theories. The cigarette manufacturer defendants, including RJR Tobacco, B&W and Lorillard Tobacco, settled the first four of these cases scheduled for trial — Mississippi, Florida, Texas and Minnesota — by separate agreements with each such state.

On November 23, 1998, the major U.S. cigarette manufacturers, including RJR Tobacco, B&W and Lorillard Tobacco, entered into the Master Settlement Agreement with attorneys general representing the remaining 46 states, the District of Columbia, Puerto Rico, Guam, the Virgin Islands, American Samoa and the

Northern Marianas. Effective on November 12, 1999, the MSA settled all the health-care cost recovery actions brought by, or on behalf of, the settling jurisdictions and released various additional present and future claims.

In the settling jurisdictions, the MSA released RJR Tobacco, B&W, Lorillard Tobacco, and their affiliates and indemnitees, including RAI and Lorillard, from:

- all claims of the settling states and their respective political subdivisions and other recipients of state health-care funds, relating to past conduct arising out of the use, sale, distribution, manufacture, development, advertising, marketing or health effects of, the exposure to, or research, statements or warnings about, tobacco products; and
- all monetary claims of the settling states and their respective political subdivisions and other recipients of state health-care funds, relating to future conduct arising out of the use of or exposure to, tobacco products that have been manufactured in the ordinary course of business.

Set forth below is the unadjusted tobacco industry settlement payment schedule (in millions) for 2014 and thereafter:

	2014	2015	2016 and thereafter
First Four States' Settlements: (1)			
Mississippi Annual Payment	$ 136	$ 136	$ 136
Florida Annual Payment	440	440	440
Texas Annual Payment	580	580	580
Minnesota Annual Payment	204	204	204
Master Settlement Agreement:			
Annual Payments (1)	8,004	8,004	8,004
Total	$9,364	$9,364	$9,364

RAI's operating subsidiaries expenses and payments under the State Settlement Agreements for 2014, 2015 and 2016 and the projected expenses and payments for 2017 and thereafter (in millions) are set forth below. (1)(2)

	2014	2015	2016	2017	2018 and thereafter
Settlement expenses	$1,917	$2,403	$2,727	—	—
Settlement cash payments	$1,985	$2,166	$3,042	—	—
Projected settlement expenses				$>3,000	$>3,000
Projected settlement cash payments				$>2,700	$>3,000

(1) Subject to adjustments for changes in sales volume, inflation, operating profit and other factors. Payments are allocated among the companies on the basis of relative market share or other methods. For further information, see "— State Settlement Agreements —Enforcement and Validity; Adjustments" below.

(2) The amounts above reflect the impact of the Term Sheet and the NY State Settlement described below under "— State Settlement Agreements — Enforcement and Validity; Adjustments — Partial Settlement of Certain NPM Adjustment Claims."

The State Settlement Agreements also contain provisions restricting the marketing of tobacco products. Among these provisions are restrictions or prohibitions on the use of cartoon characters, brand-name sponsorships, apparel and other merchandise, outdoor and transit advertising, payments for product placement, free sampling and lobbying. Furthermore, the State Settlement Agreements required the dissolution of three industry-sponsored research and trade organizations.

The State Settlement Agreements have materially adversely affected RJR Tobacco's shipment volumes. RAI believes that these settlement obligations may materially adversely affect the results of operations, cash flows or financial position of RAI and RJR Tobacco in future periods. The degree of the adverse impact will depend, among other things, on the rate of decline in U.S. cigarette sales in the premium and value categories, RJR Tobacco's share of the domestic premium and value cigarette categories, and the effect of any resulting cost advantage of manufacturers not subject to the State Settlement Agreements.

U.S. Department of Justice Case.

In *United States v. Philip Morris USA Inc.* (U.S.D.C. D.D.C., filed 1999) , the U.S. Department of Justice brought an action against RJR Tobacco, B&W, Lorillard Tobacco and other tobacco companies seeking

(1) recovery of federal funds expended in providing health care to smokers who developed alleged smoking-related diseases pursuant to the Medical Care Recovery Act and Medicare Secondary Payer provisions of the Social Security Act and (2) equitable relief under the civil provisions of RICO, including disgorgement of roughly $280 billion in profits the government contended were earned as a consequence of a purported racketeering "enterprise." In September 2000, the district court dismissed the government's Medical Care Recovery Act and Medicare Secondary Payer claims. In February 2005, the U.S. Court of Appeals for the D.C. Circuit, referred to as the D.C. Circuit, ruled that disgorgement was not an available remedy.

On August 17, 2006, after a non-jury bench trial, the district court found certain defendants, including RJR Tobacco, B&W and Lorillard Tobacco, had violated RICO, but did not impose any direct financial penalties. The district court instead enjoined RJR Tobacco, Lorillard Tobacco and the other defendants from committing future racketeering acts, participating in certain trade organizations, making misrepresentations concerning smoking and health and youth marketing, and using certain brand descriptors such as "low tar," "light," "ultra light," "mild" and "natural." The district court also ordered RJR Tobacco, Lorillard Tobacco and the other defendants to issue "corrective communications" on five subjects, including smoking and health and addiction, and to comply with further undertakings, including maintaining web sites of historical corporate documents and disseminating certain marketing information on a confidential basis to the government. In addition, the district court placed restrictions on the defendants' ability to dispose of certain assets for use in the United States, unless the transferee agrees to abide by the terms of the district court's order, and ordered certain defendants to reimburse the U.S. Department of Justice its taxable costs incurred in connection with the case.

Defendants, including RJR Tobacco, B&W, and Lorillard Tobacco, appealed, the government cross appealed, and the defendants moved in the district court for clarification and a stay pending appeal. After the district court denied the defendants' motion to stay, the D.C. Circuit granted a stay in October 2006.

The district court then granted the motion for clarification in part and denied it in part. With respect to the meaning and applicability of the general injunctive relief of the August 2006 order, the district court denied the motion for clarification. With respect to the request for clarification as to the scope of the provisions in the order prohibiting the use of descriptors and requiring corrective statements at retail point of sale, the district court granted the motion and also ruled that the provisions prohibiting the use of express or implied health messages or descriptors do apply to the actions of the defendants taken outside of the United States.

In May 2009, the D.C. Circuit largely affirmed both the finding of liability against the tobacco defendants and the remedial order, including the denial of additional remedies, but vacated the order and remanded for further proceedings as to the following four discrete issues:

- the issue of the extent of B&W's control over tobacco operations was remanded for further fact finding and clarification;
- the remedial order was vacated to the extent that it binds all defendants' subsidiaries and was remanded to the district court for determination as to whether inclusion of the subsidiaries and which of the subsidiaries satisfy Rule 65(d) of the Federal Rules of Civil Procedure;
- the D.C. Circuit held that the provision found in paragraph four of the injunction, concerning the use of any express or implied health message or health descriptor for any cigarette brand, should not be read to govern overseas sales. The issue was remanded to the district court with instructions to reformulate it so as to exempt foreign activities that have no substantial, direct and foreseeable domestic effects; and
- the remedial order was vacated regarding "point of sale" displays and remanded for the district court to evaluate and make due provisions for the rights of innocent persons, either by abandoning this part of the remedial order or re-crafting a new version reflecting the rights of third parties.

In June 2010, the U.S. Supreme Court denied all parties' petitions for writ of certiorari.

Post-remand proceedings are underway. On December 22, 2010, the district court dismissed B&W from the litigation. In November 2012, the trial court entered an order setting forth the text of the corrective statements and directed the parties to engage in discussions with the Special Master to implement them. After extensive mediation led the parties to an implementation agreement, the district court entered an implementation order on June 2, 2014. The defendants filed a consolidated appeal challenging both the content of the court-ordered statements and the requirement that those statements be published in redundant media. On May 22, 2015, the D.C. Circuit reversed the corrective statements order in part, affirmed in part, and remanded to the district court for further proceedings. On October 1, 2015, the district court ordered the parties to propose new corrective-

statements preambles. On February 8, 2016, the district court entered an order adopting the government's proposed corrective-statements preamble. The parties then mediated, per the district court's order, changes to the implementation order necessitated by the new preamble. On April 19, 2016, the district court accepted the parties' mediated agreement on implementation and entered a superseding consent order with respect to implementation. The superseding consent order stays implementation of the corrective statements until the exhaustion of appeals from the orders establishing the text of those statements and governing implementation details. On April 7, 2016, the defendants and the post-judgment parties regarding remedies noticed an appeal to the D.C. Circuit from the order adopting the government's proposed corrective-statement preambles. On May 6, 2016, the defendants and post-judgment parties regarding remedies noticed an appeal to the D.C. Circuit from the superseding consent order. On June 7, 2016, the D.C. Circuit granted the unopposed motion of the defendants and the post-judgment parties regarding remedies to consolidate the two appeals. Briefing in the consolidated appeals concluded in late December 2016, and oral argument is scheduled for February 17, 2017. Additionally, RJR Tobacco appealed the district court's May 28, 2015, order requiring RJR Tobacco to televise an additional set of corrective statements on behalf of B&W. On November 1, 2016, the D.C. Circuit upheld the order. In light of the corrective-statements implementation requirements, $20 million has been accrued for the estimated costs of the corrective communications and is included in the consolidated balance sheet as of December 31, 2016.

Native American Tribe Case.

As of December 31, 2016, one Native American tribe case was pending before a tribal court against RJR Tobacco, B&W and Lorillard Tobacco, *Crow Creek Sioux Tribe v. American Tobacco Co.* (Tribal Ct., Crow Creek Sioux, S.D., filed 1997). The plaintiffs seek to recover actual and punitive damages, restitution, funding of a clinical cessation program, funding of a corrective public education program, and disgorgement of unjust profits from sales to minors. The plaintiffs claim that the defendants are liable under the following theories: unlawful marketing and targeting of minors, contributing to the delinquency of minors, unfair and deceptive acts or practices, unreasonable restraint of trade and unfair method of competition, negligence, negligence per se, conspiracy and restitution of unjust enrichment. The case is dormant.

International Cases.

Each of the ten Canadian provinces has filed a health-care cost recovery action against Canadian and non-Canadian tobacco-related entities, including RJR Tobacco and one of its affiliates. In these actions, which are described below, each of the Canadian provinces seeks to recover for health care, medical and other assistance paid and to be paid for treating tobacco-related disease. Pursuant to the terms of the 1999 sale of RJR Tobacco's international tobacco business, RJR Tobacco has tendered the defense of these actions to JTI. Subject to a reservation of rights, JTI has assumed the defense of RJR Tobacco and its affiliate in these actions.

- *British Columbia* (British Columbia Sup. Ct., Vancouver Registry, filed 1997) — In 1997, British Columbia enacted a statute creating a civil cause of action against tobacco-related entities for the provincial government to recover the costs of health-care benefits incurred for insured British Columbia residents resulting from tobacco-related disease. An initial action brought pursuant to the statute against Canadian and non-Canadian tobacco-related entities, including RJR Tobacco and certain of its affiliates, was dismissed in February 2000 when the British Columbia Supreme Court ruled that the legislation was unconstitutional. British Columbia then enacted a revised statute, pursuant to which an action was filed in January 2001 against many of the same defendants, including RJR Tobacco and one of its affiliates. In that action, the British Columbia government seeks to recover the present value of its total expenditures for health-care benefits provided for insured persons resulting from tobacco-related disease or the risk of tobacco-related disease caused by alleged breaches of duty by the manufacturers, the present value of its estimated total expenditures for health-care benefits that reasonably could be expected to be provided for those insured persons resulting from tobacco-related disease or the risk of tobacco-related disease in the future, court ordered interest, and costs, or in the alternative, special or increased costs. The government alleges that the defendants are liable under the British Columbia statute by reason of their "tobacco related wrongs," which are alleged to include: selling defective products, failure to warn, sale of cigarettes to children and adolescents, strict liability, deceit and misrepresentation, violation of trade practice and competition acts, concerted action, and joint liability. RJR Tobacco and its affiliate filed statements of defense in January 2007. Pretrial discovery is ongoing.
- *New Brunswick* (Ct. of Queen's Bench of New Brunswick, Jud. Dist. Fredericton, filed 2008) — This claim is brought pursuant to New Brunswick legislation enacted in 2008 that is substantially similar to

the revised British Columbia statute described above. It seeks recovery of essentially the same types of damages sought in the British Columbia action based on analogous theories of liability. RJR Tobacco and its affiliate filed statements of defense in March 2010. Pretrial discovery is ongoing.

- *Ontario* (Ontario Super. Ct. Justice, Toronto, filed 2009) - This claim is brought pursuant to Ontario legislation that is substantially similar to the revised British Columbia statute described above. It seeks recovery of essentially the same types of damages sought in the British Columbia action based on analogous theories of liability, although the government also asserted claims based on the illegal importation of cigarettes, which claims were deleted in an amended statement of claim filed in August 2010. RJR Tobacco and its affiliate filed statements of defense in April 2016.

- *Newfoundland and Labrador* (Sup. Ct. Newfoundland and Labrador, St. John's, filed 2011) - This claim is brought pursuant to Newfoundland and Labrador legislation that is substantially similar to the revised British Columbia statute described above. It seeks recovery of essentially the same types of damages sought in the British Columbia action based on analogous theories of liability. RJR Tobacco and its affiliate filed statements of defense in May 2016.

- *Manitoba* (Ct. of Queen's Bench, Winnipeg Jud. Centre, filed 2012) - This claim is brought pursuant to Manitoba legislation that is substantially similar to the revised British Columbia statute described above. It seeks recovery of essentially the same types of damages sought in the British Columbia action based on analogous theories of liability. RJR Tobacco and its affiliate filed statements of defense in September 2014. Pre-trial discovery is ongoing.

- *Quebec* (Super. Ct. Quebec, Dist. Montreal, filed 2012) - This claim is brought pursuant to Quebec legislation that is substantially similar to the revised British Columbia statute described above. It seeks recovery of essentially the same types of damages being sought in the British Columbia action based on analogous theories of liability. RJR Tobacco and its affiliate filed defenses in December 2014. Pretrial discovery is ongoing.

- *Saskatchewan* (Ct. of Queen's Bench, Jud. Centre Saskatoon, filed 2012) - This claim is brought pursuant to Saskatchewan legislation that is substantially similar to the revised British Columbia statute described above. It seeks recovery of essentially the same types of damages sought in the British Columbia action based on analogous theories of liability. RJR Tobacco and its affiliate filed statements of defense in February 2015.

- *Alberta* (Ct. of Queen's Bench, Alberta Jud. Centre of Calgary, filed 2012) - This claim is brought pursuant to Alberta legislation that is substantially similar to the revised British Columbia statute described above. It seeks recovery of essentially the same types of damages sought in the British Columbia action based on analogous theories of liability. RJR Tobacco and its affiliate filed statements of defense in March 2016.

- *Prince Edward Island* (Sup. Ct. P.E.I., Charlottetown, filed 2012) — This claim is brought pursuant to Prince Edward Island legislation that is substantially similar to the revised British Columbia statute described above. It seeks recovery of essentially the same types of damages sought in the British Columbia action based on analogous theories of liability. RJR Tobacco and its affiliate filed statements of defense in February 2015.

- *Nova Scotia* (Sup. Ct. Nova Scotia, Halifax, filed 2015) — This claim is brought pursuant to Nova Scotia legislation that is substantially similar to the revised British Columbia statute described above. It seeks recovery of essentially the same types of damages sought in the British Columbia action based on analogous theories of liability. RJR Tobacco and its affiliate filed statements of defense in July 2015.

Seven putative class actions, which are described below, have been filed against various Canadian and non-Canadian tobacco-related entities, including RJR Tobacco and one of its affiliates, in Canadian provincial courts. In these cases, the plaintiffs allege claims based on fraud, fraudulent concealment, breach of warranty, breach of warranty of merchantability, and of fitness for a particular purpose, failure to warn, design defects, negligence, breach of a "special duty" to children and adolescents, conspiracy, concert of action, unjust enrichment, market share liability, and violations of various trade practices and competition statutes. The plaintiffs seek recovery on behalf of proposed classes of persons allegedly suffering from tobacco-related disease as a result of smoking defendants' cigarettes and seek recovery of compensatory and punitive damages, restitution, recovery of government health-care benefits, interest, and costs. Pursuant to the terms of the 1999 sale of RJR Tobacco's international tobacco business, RJR Tobacco has tendered the defense of these seven actions to

JTI. Subject to a reservation of rights, JTI has assumed the defense of RJR Tobacco and its current or former affiliates in these actions. Plaintiffs' counsel have been actively pursuing only *Bourassa* , the action pending in British Columbia, at this time.

- In *Kunka v. Canadian Tobacco Manufacturers' Council* (Ct. of Queen's Bench, Winnipeg Jud. Centre, filed 2009), the plaintiff seeks compensatory and punitive damages on behalf of a proposed class of persons who purchased or smoked defendants' cigarettes and suffered, or currently suffer, from tobacco-related disease, as well as restitution of profits and reimbursement of government expenditure for health-care benefits allegedly caused by the use of tobacco products.
- In *Dorion v. Canadian Tobacco Manufacturers' Council* (Ct. of Queen's Bench, Alberta Jud. Centre of Calgary – filed 2009), the plaintiff seeks compensatory and punitive damages on behalf of a proposed class of persons who purchased or smoked defendants' cigarettes and suffered, or currently suffer, from tobacco-related disease, as well as restitution of profits and reimbursement of government expenditure for health-care benefits allegedly caused by the use of tobacco products.
- In *Semple v. Canadian Tobacco Manufacturers' Council* (Sup. Ct. Nova Scotia, Halifax, filed 2009), the plaintiff seeks compensatory and punitive damages on behalf of a proposed class comprised of persons who purchased or smoked defendants' cigarettes for the period from January 1, 1954, to the expiry of the opt-out period as set by the court and suffered, or currently suffer, from tobacco-related disease, as well as restitution of profits and reimbursement of government expenditure for health-care costs allegedly caused by the use of tobacco products.
- In *Adams v. Canadian Tobacco Manufacturers' Council* (Ct. of Queen's Bench, Jud. Centre of Regina, filed 2009), the plaintiff seeks compensatory and punitive damages on behalf of a proposed class of persons who were alive on July 10, 2009, and suffered, or currently suffer, from chronic obstructive pulmonary disease, emphysema, heart disease or cancer, after having smoked a minimum of 25,000 of defendants' cigarettes, as well as disgorgement of revenues earned by the defendants. RJR Tobacco and its affiliate have brought a motion challenging the jurisdiction of the Saskatchewan court.
- In *Bourassa v. Imperial Tobacco Canada Ltd.* (Sup. Ct. of British Columbia, Victoria Registry, filed 2010), the plaintiff seeks compensatory and punitive damages on behalf of a proposed class of persons who were alive on June 12, 2007, and suffered, or currently suffer, from chronic respiratory diseases, after having smoked a minimum of 25,000 of defendants' cigarettes, as well as disgorgement of revenues earned by the defendants from January 1, 1954, to the date the claim was filed. RJR Tobacco and its affiliate have filed a challenge to the jurisdiction of the British Columbia court. The plaintiff filed a motion for certification in April 2012, and filed affidavits in support in August 2013. An amended claim was filed in December 2014.
- In *McDermid v. Imperial Tobacco Canada Ltd.* (Sup. Ct. of British Columbia, Victoria Registry, filed 2010), the plaintiff seeks compensatory and punitive damages on behalf of a proposed class of persons who were alive on June 12, 2007, and suffered, or currently suffer, from heart disease, after having smoked a minimum of 25,000 of defendants' cigarettes, as well as disgorgement of revenues earned by the defendants from January 1, 1954, to the date the claim was filed. RJR Tobacco and its affiliate have filed a challenge to the jurisdiction of the British Columbia court.
- In *Jacklin v. Canadian Tobacco Manufacturers' Council* (Ontario Super. Ct. of Justice, St. Catherines, filed 2012), the plaintiff seeks compensatory and punitive damages on behalf of a proposed class of persons who were alive on June 12, 2007, and suffered, or currently suffer, from chronic obstructive pulmonary disease, heart disease, or cancer, after having smoked a minimum of 25,000 of defendants' cigarettes, as well as restitution of profits, and reimbursement of government expenditure for health-care benefits allegedly caused by the use of tobacco products.

State Settlement Agreements — Enforcement and Validity; Adjustments

As of December 31, 2016, there were 28 cases concerning the enforcement, validity or interpretation of the State Settlement Agreements in which RJR Tobacco, B&W or Lorillard Tobacco is a party. This number includes those cases, discussed below, relating to disputed payments under the State Settlement Agreements.

In May 2006, the State of Florida filed a motion, in the Circuit Court of the Fifteenth Judicial Circuit, in and for Palm Beach County, Florida, to enforce the Florida settlement agreement, referred to as the Florida Settlement Agreement, for an accounting by Brown & Williamson Holdings, Inc., and for an Order of Contempt.

The State asserted that B&W failed to report in its net operating profit on its shipments, cigarettes manufactured by B&W under contract for Star Tobacco or its parent, Star Scientific, Inc. The State is seeking approximately $12.4 million in additional payments under the Florida Settlement Agreement, as well as $17.0 million in interest payments. This matter is currently in the discovery phase.

On January 18, 2017, the State of Florida filed a motion to enjoin ITG as a defendant and to enforce the Florida Settlement Agreement. The State's motion seeks payment under the Florida Settlement Agreement with respect to the four brands (WINSTON, SALEM, KOOL and MAVERICK) that were sold to ITG in the Divestiture. Under the asset purchase agreement relating to the Divestiture (and related documents), ITG was to assume responsibility with respect to these brands. Since the closing of the Divestiture and the transfer of these brands to it, ITG has not made settlement payments to the State with respect to these brands. The State's motion asserts that it "is presently owed more than $45 million and will continue to suffer annual losses of approximately $30 million absent the Court's enforcement of the Settlement Agreement…." The State's motion seeks, among other things, an order from the court declaring that RJR Tobacco and ITG are in breach of the Florida Settlement Agreement and are required, jointly and severally, to make annual payments to the State under the Florida Settlement Agreement with respect to the brands transferred to ITG in the Divestiture.

Also on January 18, 2017, Philip Morris USA, Inc. filed a motion to enforce the Florida Settlement Agreement. Philip Morris USA, Inc.'s motion asserted that RJR Tobacco and ITG have breached the Florida Settlement Agreement by failing to comply with the obligations under the Florida Settlement Agreement with respect to the transferred brands. Philip Morris USA, Inc.'s motion asserts that RJR Tobacco and ITG have "…deprived the State…of over $40 million in settlement payments and improperly shifted millions of the remaining settlement payment obligations from themselves to Philip Morris USA, Inc., amounts that will increase greatly going forward absent intervention by [the] Court." Philip Morris USA, Inc.'s motion seeks various forms of relief to modify the settlement payment calculations to address the issues raised in its motion.

On January 27, 2017, RJR Tobacco filed a motion asserting that ITG failed to use its reasonable best efforts to join the Florida Settlement Agreement and breached the asset purchase agreement relating to the Divestiture. Accordingly, RJR Tobacco filed a motion for leave to allow a supplemental pleading for breach by ITG of its obligations regarding joinder into the Florida Settlement Agreement.

NPM Adjustment Claims. The MSA includes an adjustment that potentially reduces the annual payment obligations of RJR Tobacco, Lorillard Tobacco and the other PMs. Certain requirements, collectively referred to as the Adjustment Requirements, must be satisfied before the NPM Adjustment for a given year is available:

- an Independent Auditor must determine that the PMs have experienced a market share loss, beyond a triggering threshold, to those manufacturers that do not participate in the MSA, such non-participating manufacturers referred to as NPMs; and
- in a binding arbitration proceeding, a firm of independent economic consultants must find that the disadvantages of the MSA were a significant factor contributing to the loss of market share. This finding is known as a significant factor determination.

When the Adjustment Requirements are satisfied, the MSA provides that the NPM Adjustment applies to reduce the annual payment obligation of the PMs. However, an individual settling state may avoid its share of the NPM Adjustment if it had in place and diligently enforced during the entirety of the relevant year a "Qualifying Statute" that imposes escrow obligations on NPMs that are comparable to what the NPMs would have owed if they had joined the MSA. In such event, the state's share of the NPM Adjustment is reallocated to other settling states, if any, that did not have in place and diligently enforce a Qualifying Statute.

NPM Adjustment Claim for 2003. For 2003, the Adjustment Requirements were satisfied. As a result, based on revised numbers calculated by the Independent Auditor, RJR Tobacco placed approximately $615 million, and Lorillard Tobacco placed approximately $109 million, of its 2006 and 2007 MSA payments into a disputed payments account, in accordance with a procedure established by the MSA.

As a result of this action, 37 of the settling states filed legal proceedings in their respective MSA courts seeking declaratory orders that they diligently enforced their Qualifying Statutes during 2003 and/or orders compelling RJR Tobacco and the other PMs that placed money in the disputed payments account to pay the disputed amounts to the settling states. In response, RJR Tobacco and other PMs, pursuant to the MSA's arbitration provisions, moved to compel arbitration of the parties' dispute concerning the 2003 NPM Adjustment, including the states' diligent enforcement claims, before an arbitration panel consisting of three retired federal court judges. The settling states opposed these motions, arguing, among other things, that the issue of diligent enforcement must be resolved by MSA courts in each of the 52 settling states and territories.

Forty-seven of the 48 courts that addressed the question whether the dispute concerning the 2003 NPM Adjustment is arbitrable ruled that arbitration was required under the MSA. The Montana Supreme Court ruled that the State of Montana did not agree to arbitrate the question of whether it diligently enforced a Qualifying Statute. Subsequently, Montana and the PMs reached an agreement whereby the PMs agreed not to contest Montana's claim that it diligently enforced the Qualifying Statute during 2003.

In January 2009, RJR Tobacco and certain other PMs entered into an Agreement Regarding Arbitration, referred to as the Arbitration Agreement, with 45 of the MSA settling states (representing approximately 90% of the allocable share of the settling states) pursuant to which those states agreed to participate in a multistate arbitration of issues related to the 2003 NPM Adjustment. Under the Arbitration Agreement, the signing states had their ultimate liability, if any, with respect to the 2003 NPM Adjustment reduced by 20%, and RJR Tobacco and the other PMs that placed their share of the disputed 2005 NPM Adjustment (discussed below) into the disputed payments account, without releasing or waiving any claims, authorized the release of those funds to the settling states.

The arbitration panel contemplated by the MSA and the Arbitration Agreement, referred to as the Arbitration Panel, was selected, and proceedings before the panel with respect to the 2003 NPM Adjustment claim began in July 2010. Following the completion of document and deposition discovery, on November 3, 2011, RJR Tobacco and the other PMs advised the Arbitration Panel that they were not contesting the "diligent enforcement" of 12 states and the four U.S. territories with a combined allocable share of less than 14%. The "diligent enforcement" of the remaining 33 settling states, the District of Columbia and Puerto Rico was contested and became the subject of further proceedings. A common issues hearing was held in April 2012, and state specific evidentiary hearings with respect to the contested states were initiated.

As a result of the partial settlement of certain NPM Adjustment claims, as described in more detail below, as well as the earlier decisions not to contest the diligent enforcement of 12 states, two of which are participants in the partial settlement, and the four U.S. territories, only 15 contested settling states required state specific diligent enforcement rulings. State specific evidentiary hearings were completed in May 2013.

In September 2013, the Arbitration Panel issued rulings with respect to the 15 remaining contested states. The Arbitration Panel ruled that six states — Indiana, Kentucky, Maryland, Missouri, New Mexico and Pennsylvania (collectively representing approximately 14.68% allocable share) — had not diligently enforced their Qualifying Statutes in 2003. Each of these six states filed motions to vacate and/or modify the diligent enforcement rulings on the 2003 NPM Adjustment claim. The status as to each of these states is as follows:

- Indiana and Kentucky (representing approximately 3.80% allocable share) subsequently joined the partial settlement of certain NPM Adjustment claims, as described in more detail below. Indiana participated in a joint motion to stay indefinitely further proceedings on the motions it had filed to vacate the settlement and to modify the adverse diligent enforcement ruling against it. Similarly, Kentucky has joined in a stipulation by the parties filed with the court in that state to stay further proceedings on its motions, but that stipulation has not yet been signed by the court.

- Pennsylvania dropped its challenge to the finding of non-diligence entered against it. However, the state court in Pennsylvania entered an order that modified the judgment reduction method that had been adopted by the Arbitration Panel, which reduced RJR Tobacco's and Lorillard Tobacco's recovery from this state by \$54.0 million and \$9.5 million, respectively. Upon appeal, in April 2015, the intermediate appellate court in Pennsylvania upheld the trial court ruling. The Pennsylvania Supreme Court declined to take the industry's appeal of that ruling. RJR Tobacco filed a petition for writ of certiorari with the U.S. Supreme Court on April 21, 2016. On October 11, 2016, the U.S. Supreme Court denied RJR Tobacco's petition for writ of certiorari.

- Missouri dropped its challenge to the finding of non-diligence entered against it. However, the state court in Missouri entered an order that modified the judgment reduction method that had been adopted by the Arbitration Panel which reduced RJR Tobacco's and Lorillard Tobacco's recovery from this state by \$21.4 million and \$3.8 million, respectively. Upon appeal, in September 2015, the intermediate appellate court in Missouri reversed the trial court ruling. Missouri is appealing that ruling to the Missouri Supreme Court. The appeal is fully briefed, and oral argument on the appeal was held on November 8, 2016. A decision is pending.

- Maryland dropped its challenge to the finding of non-diligence entered against it. Maryland's motion challenging the judgment reduction method adopted by the Arbitration Panel was denied by its state court. Upon appeal, in October 2015, the intermediate appellate court in Maryland reversed the trial

court, the effect of which was to reduce RJR Tobacco's and Lorillard Tobacco's recovery from this state by a total of $21.2 million and $3.7 million, respectively. The Maryland Supreme Court declined to take the industry's appeal of that ruling. RJR Tobacco filed a petition for writ of certiorari with the U.S. Supreme Court on June 22, 2016. On October 11, 2016, the U.S. Supreme Court denied RJR Tobacco's petition for writ of certiorari.

- New Mexico filed motions challenging the finding of non-diligence and seeking a modification of the judgment reduction method adopted by the Arbitration Panel. The New Mexico trial court denied the state's motion to vacate the finding of non-diligence, but granted the state's motion challenging the judgment reduction method that had been adopted by the Arbitration Panel, which reduced RJR Tobacco's and Lorillard Tobacco's recovery from this state by $5.6 million and $1 million, respectively. RJR Tobacco has appealed the court's ruling on the judgment reduction method. The State did not appeal the trial court's denial of its motion to vacate the finding on non-diligence.

As noted above, the effect from the four non-diligent states, Pennsylvania, Missouri, Maryland and New Mexico, no longer challenging the findings of non-diligence entered against them by the Arbitration Panel was that a certain portion of the potential recovery from these four states was probable and reasonably estimable. Consequently, $6 million and $93 million was recognized as a reduction of cost of products sold in RAI's consolidated statement of income for the year ended December 31, 2016 and 2015, respectively. Therefore, RJR Tobacco now estimates that the maximum remaining amount of its claim and Lorillard Tobacco's claim with respect to the 2003 NPM Adjustment claim is $27 million and $5 million, respectively, plus any applicable interest and earnings. Until such time as the various remaining state motions challenging the rulings of the Arbitration Panel have been resolved, including any necessary appeals, uncertainty exists as to the timing, process and amount of RJR Tobacco's ultimate recovery with respect to its remaining share of the 2003 NPM Adjustment claim and, accordingly, no additional amounts for the remaining four non-diligent states have been recognized in RAI's consolidated financial statements as of December 31, 2016.

NPM Adjustment Claims for 2004-2015 . From 2006 to 2008, proceedings (including significant factor arbitrations before an independent economic consulting firm) were initiated with respect to the NPM Adjustment for 2004, 2005 and 2006. Ultimately, the Adjustment Requirements were satisfied with respect to each of these NPM Adjustments.

In subsequent years, RJR Tobacco, Lorillard Tobacco, certain other PMs and the settling states entered into three separate agreements, covering fiscal years 2007 to 2009, fiscal years 2010 to 2012 and fiscal years 2013 to 2014, respectively, wherein the settling states would not contest that the disadvantages of the MSA were "a significant factor contributing to" the market share loss experienced by the PMs in those years. The stipulation pertaining to each of the years covered by the three agreements became effective in February of the year a final determination by the firm of independent economic consultants would otherwise have been expected if the issue had been arbitrated on the merits. RJR Tobacco and the PMs paid certain amounts into the States' Antitrust/ Consumer Protection Tobacco Enforcement Fund established under Section VIII(c) of the MSA for each year covered by these agreements, with RJR Tobacco paying approximately 47% and Lorillard Tobacco paying approximately 20% of such amounts.

Based on the payment calculations of the Independent Auditor and the agreements described above regarding the significant factor determinations, the Adjustment Requirements have been satisfied with respect to the NPM Adjustments for fiscal years 2007 to 2013. Determination of satisfaction of the Adjustment Requirements for 2014 has not been made. The approximate maximum principal amounts of RJR Tobacco's and Lorillard Tobacco's shares of the disputed NPM Adjustments for the years 2004 through 2014 (in millions) , as currently calculated by the Independent Auditor, and the remaining amounts after the settlements of certain NPM Adjustments claims (see below), are as follows (1) :

	RJR Tobacco		Lorillard Tobacco	
Volume Year	Disputed	Remaining after settlements	Disputed	Remaining after settlements
2004	$562	$210	$111	$41
2005	445	166	76	29
2006	419	156	73	27
2007	435	166	83	32
2008	468	179	104	40
2009	472	180	107	41
2010	470	179	119	46
2011	422	161	88	34
2012	428	163	96	37
2013	455	173	91	35
2014	430	164	92	36

(1) The amounts shown above do not include the interest or earnings thereon to which RJR Tobacco and Lorillard Tobacco believe they would be entitled under the MSA.

In addition to the above, SFNTC's portion of the disputed NPM Adjustments for the years 2004 through 2014 is approximately $67 million and the remaining amount after the settlements is approximately $26 million.

The 2015 volume year NPM Adjustments for RJR Tobacco, Lorillard Tobacco and SFNTC are $481 million, $41 million and $18 million, respectively.

The 2004 NPM Adjustment proceeding is underway before two overlapping panels, with one panel hearing the issues with respect to five states and the other panel hearing the issues as to the remaining states that will be part of the arbitration. A case management order governing the arbitration was entered on June 14, 2016. Under the timing established by that case management order, it is expected that discovery in the arbitration proceedings will be completed by the end of the second quarter of 2017 and that a hearing on common issues will take place before the end of the third quarter of 2017. State specific evidentiary hearings are expected to begin in the fourth quarter of 2017 and will likely conclude by the end of the third quarter of 2018. Diligent enforcement rulings from the panels are likely by the end of the fourth quarter of 2018. RJR Tobacco's and Lorillard Tobacco's remaining claim with respect to 2004 is approximately $251 million.

Missouri has obtained an order from the Missouri court of appeals for a separate state specific arbitration of the diligent enforcement issue, although that ruling is on appeal. Also, in the context of the 2003 NPM Adjustment proceedings, Montana obtained a ruling from the Montana Supreme Court that the issue of diligent enforcement under the MSA must be heard before that state's MSA court. Finally, New Mexico and the four U.S. territories have been asked to join the 2004 NPM Adjustment Arbitration, but have not yet done so.

Due to the uncertainty over the final resolution of the 2004-2015 NPM Adjustment claims asserted by RJR Tobacco (including Lorillard Tobacco claims) and SFNTC, no assurances can be made related to the amounts, if any, that will be realized or any amounts (including interest) that will be owed, except as described below related to the partial settlement of certain NPM Adjustment claims.

Settlement/Partial Settlement of Certain NPM Adjustment Claims. In November 2012, RJR Tobacco, certain other PMs and certain settling states entered into a Term Sheet that set forth terms on which accrued and potential NPM Adjustment claims for 2003 through 2014 could be resolved. The Term Sheet also set forth a restructured NPM Adjustment process to be applied on a going-forward basis, starting with the 2013 volume year. The Term Sheet was provided to all of the MSA settling states for their review and consideration. A total of 17 states, the District of Columbia and Puerto Rico, collectively representing approximately 42% allocable share, joined the proposed settlement. RJR Tobacco and the other PMs indicated that they were prepared to go forward with the proposed settlement with that level of jurisdictional participation.

The Term Sheet provided that the Arbitration Panel in place to deal with the 2003 NPM Adjustment (and other NPM Adjustment-related matters) must review the proposed settlement and enter an appropriate order to confirm for the Independent Auditor that it should implement, as necessary, the terms of the settlement agreement.

In March 2013, the Arbitration Panel entered a Stipulated Partial Settlement and Award, referred to as the Award, reflecting the financial terms of the Term Sheet. Shortly thereafter, the Independent Auditor issued a notice indicating that it intended to implement the financial provisions of the Term Sheet, and also issued various revised payment calculations pertaining to payment years 2009 through 2012 and final calculations pertaining to payment year 2013 that reflected implementation of the financial provisions of the Term Sheet.

Subsequently in 2013, Oklahoma, Connecticut and South Carolina joined the Term Sheet. Efforts by two states, Colorado and Ohio, to obtain injunctions to prevent implementation of the Award were unsuccessful that year.

In June 2014, Kentucky and Indiana, both of which were among the states found "non-diligent" by the Arbitration Panel, joined the Term Sheet on financial terms more favorable to the industry than those agreed to by the original signatory states. Twenty-four jurisdictions have joined the settlement representing approximately 49.87% allocable share.

On October 20, 2015, RJR Tobacco and certain other PMs (including SFNTC) entered into the NY Settlement Agreement with the State of New York to settle certain claims related to the NPM Adjustment. The NY Settlement Agreement resolves NPM Adjustment claims related to payment years from 2004 through 2014 and puts in place a new method to determine future adjustments from 2015 forward as to New York. With the addition of New York's allocable share of 12.76%, RJR Tobacco has resolved the 2004 through 2014 NPM Adjustments with 25 jurisdictions, representing approximately 62.63% allocable share.

On February 8, 2016, Missouri conditionally joined the Term Sheet on financial terms more favorable to the industry than those received by the original signatory states. Various provisions regarding the timing of credits to be received by RJR Tobacco and the other PMs and disbursements to Missouri from the Disputed Payments Account are also set forth in the conditional joinder. Missouri's joinder was conditioned upon the enactment by the Missouri legislature of Allocable Share Repeal legislation in Missouri with an effective date making such legislation applicable to NPM cigarettes sold in Missouri beginning no later than August 28, 2016. This condition was not satisfied, and thus the conditional joinder was terminated.

For additional information related to the Term Sheet, the NY Settlement Agreement and the 2003 NPM Adjustment, see "— Cost of Products Sold" in note 1.

Other Litigation and Developments

JTI Claims for Indemnification. By a purchase agreement dated March 9, 1999, amended and restated as of May 11, 1999, referred to as the 1999 Purchase Agreement, RJR and RJR Tobacco sold its international tobacco business to JTI. Under the 1999 Purchase Agreement, RJR and RJR Tobacco retained certain liabilities relating to the international tobacco business sold to JTI. Under its reading of the indemnification provisions of the 1999 Purchase Agreement, JTI has requested indemnification for damages allegedly arising out of these retained liabilities. As previously reported, a number of the indemnification claims between the parties relating to the activities of Northern Brands in Canada have been resolved. The other matters for which JTI has requested indemnification for damages under the indemnification provisions of the 1999 Purchase Agreement are described below:

- In a letter dated March 31, 2006, counsel for JTI stated that JTI would be seeking indemnification under the 1999 Purchase Agreement for any damages it may incur or may have incurred arising out of a Southern District of New York grand jury investigation, a now-terminated Eastern District of North Carolina grand jury investigation, and various actions filed by the European Community and others in the U.S. District Court for the Eastern District of New York, referred to as the EDNY, against RJR Tobacco and certain of its affiliates on November 3, 2000, August 6, 2001, and (as discussed in greater detail below) October 30, 2002, and against JTI on January 11, 2002.
- JTI also has sought indemnification relating to a Statement of Claim filed on April 23, 2010, in the Ontario Superior Court of Justice, London, against JTI Macdonald Corp., referred to as JTI-MC, by the Ontario Flue-Cured Tobacco Growers' Marketing Board, referred to as the Board, Andy J. Jacko, Brian Baswick, Ron Kichler, and Aprad Dobrenty, proceeding on their own behalf and on behalf of a putative

class of Ontario tobacco producers that sold tobacco to JTI-MC during the period between January 1, 1986 and December 31, 1996, referred to as the Class Period, through the Board pursuant to certain agreements. The Statement of Claim seeks recovery for damages allegedly incurred by the class representatives and the putative class for tobacco sales during the Class Period made at the contract price for duty free or export cigarettes with respect to cigarettes that, rather than being sold duty free or for export, purportedly were sold in Canada, which allegedly breached one or more of a series of contracts dated between June 4, 1986, and July 3, 1996. Appeals taken from an unsuccessful motion to dismiss the action as barred by the statute of limitations were ultimately denied on November 4, 2016. Certification proceedings are pending.

- Finally, JTI has advised RJR and RJR Tobacco of its view that, under the terms of the 1999 Purchase Agreement, RJR and RJR Tobacco are liable for approximately $1.85 million related to a judgment entered in 1998, plus interest and costs, in an action filed in Brazil by Lutz Hanneman, a former employee of a former RJR Tobacco subsidiary. RJR and RJR Tobacco deny that they are liable for this judgment under the terms of the 1999 Purchase Agreement.

Although RJR and RJR Tobacco recognize that, under certain circumstances, they may have these and other unresolved indemnification obligations to JTI under the 1999 Purchase Agreement, RJR and RJR Tobacco disagree with JTI as to (1) what circumstances relating to any such matters may give rise to indemnification obligations by RJR and RJR Tobacco, and (2) the nature and extent of any such obligation. RJR and RJR Tobacco have conveyed their position to JTI, and the parties have agreed to resolve their differences at a later time.

European Community. In *European Community v. RJR Nabisco, Inc.* (U.S.D.C. E.D.N.Y., filed 2002), the European Community and several of its member states allege that RJR, RJR Tobacco and other currently and formerly related companies engaged in money laundering and other conduct violating civil RICO and a variety of common laws. The plaintiffs also allege that the defendants manufactured cigarettes that were eventually sold in Iraq in violation of U.S. sanctions. The plaintiffs seek compensatory, punitive and treble damages among other types of relief. On February 15, 2010, the defendants moved to dismiss, and the action has been stayed and largely inactive since then while the parties have litigated that motion. On March 8, 2011, the district court granted the defendants' motion in part and dismissed the plaintiffs' RICO claims. On May 13, 2011, the district court granted the remaining portion of the defendants' motion and dismissed the plaintiffs' state-law claims based on the court's lack of subject matter jurisdiction. The plaintiffs appealed to the Second Circuit.

On April 29, 2014, the Second Circuit vacated and remanded in a decision concluding that (1) as pled, the RICO claims are within the scope of the RICO statute, and (2) the federal court has subject matter jurisdiction over the state-law claims. The defendants sought rehearing and rehearing *en banc*. On August 20, 2014, the Second Circuit denied panel rehearing and issued an amended opinion that, in addition to adhering to the earlier opinion, held that a civil RICO cause of action extends to extraterritorial injuries. The U.S. Supreme Court granted certiorari and, on June 20, 2016, reversed the Second Circuit's decision and ordered the dismissal of the plaintiffs' RICO damages claims, finding that RICO civil causes of action extend only to domestic injuries, which claims the plaintiffs had abandoned. The court also held that any private RICO claims for equitable relief must also rest on domestic injuries but reserved decision on whether the plaintiffs had alleged such claims. The court's decision does not affect the plaintiffs' common-law claims. After remand, the district court entered an order allowing the plaintiffs to file an amended complaint by October 24, 2016, which later was extended indefinitely. Once the amended complaint is filed, the parties have been directed to submit a joint briefing schedule for the defendants' anticipated motion to dismiss. Further, the district court stayed discovery until ten days after entry of an order deciding the defendants' anticipated motion to dismiss.

Fontem Patent Litigation. On April 4, 2016, a case was filed in federal court, *Fontem Ventures B.V. and Fontem Holdings 1 B.V. v. R. J. Reynolds Vapor Company* (U.S.D.C. C.D. Cal.), which alleges that VUSE products infringe four patents owned by Fontem purportedly directed to e-cigarettes. On May 3, 2016, Fontem filed a second complaint asserting that the VUSE products infringe two additional Fontem patents purportedly directed to e-cigarettes. On June 22, 2016, Fontem filed a third complaint asserting that the VUSE products infringe one additional Fontem patent purportedly directed to e-cigarettes. RJR Vapor filed an answer in the first case on June 27, 2016, and an amended answer on July 25, 2016. RJR Vapor also filed answers in the second and third cases on July 25, 2016. On June 29, 2016, RJR Vapor filed a motion to transfer the three cases to the Middle District of North Carolina, which was granted on August 8, 2016. The cases are now pending in the Middle District of North Carolina.

Also, RJR Vapor has filed petitions for *inter partes* review against six of the seven asserted patents. Two of the petitions have been granted, two denied, and the others are still pending decision.

FDA Litigation. On February 25, 2011, RJR Tobacco, Lorillard and Lorillard Tobacco jointly filed a lawsuit, *Lorillard, Inc. v. U.S. Food and Drug Administration*, in the U.S. District Court for the District of Columbia, challenging the composition of TPSAC which had been established by the FDA under the Family Smoking Prevention and Tobacco Control Act, referred to as the FDA Tobacco Act. The complaint alleges that certain members of the TPSAC and certain members of its Constituents Subcommittee have financial and appearance conflicts of interest that are disqualifying under federal ethics law and regulations, and that the TPSAC is not "fairly balanced," as required by the Federal Advisory Committee Act, referred to as FACA. In March 2011, the plaintiffs filed an amended complaint, which added an additional claim, based on a nonpublic meeting of members of the TPSAC, in violation of the FACA. The court granted the plaintiffs' unopposed motion to file a second amended complaint adding a count addressing the FDA's refusal to produce all documents generated by the TPSAC and its subcommittee in preparation of the menthol report. On July 21, 2014, the court granted the plaintiffs' summary judgment motions finding that three members of the TPSAC Committee had impermissible conflicts of interest. As relief, the court ordered the FDA to reconstitute the committee in conformance with the law and enjoined the agency from using or relying on the TPSAC's 2011 Menthol Report. On September 18, 2014, the FDA appealed the decision to the D.C. Circuit. On January 15, 2016, the appellate court reversed the decision of the district court, finding that the plaintiffs did not have standing to challenge appointments of certain TPSAC members. Under the appellate court's order, the three former committee members can serve once again on the TPSAC and FDA can rely on the TPSAC menthol report. On May 9, 2016, the plaintiffs' petition for rehearing or rehearing *en banc* was denied. On May 18, 2016, the appellate court issued a mandate vacating the injunction that had barred use of the TPSAC menthol report and had ordered reconstitution of the TPSAC.

For a detailed description of the FDA Tobacco Act, see "— Governmental Activity" in "Management's Discussion and Analysis of Financial Condition and Results of Operations," in Part II, Item 7.

Smokeless Tobacco Litigation

In 1999, when the IPIC litigation was first filed, the named defendants included manufacturers of smokeless products, including Conwood Company, LLC (now known as American Snuff Company, LLC) and others. When the IPIC plaintiffs filed discovery responses in IPIC listing the products they used, 41 of them listed a smokeless product. Six of those 41 plaintiffs listed a brand owned by American Snuff (Levi Garrett). Seven listed a brand (Beechnut) once manufactured by Lorillard Tobacco (now manufactured by National Tobacco Company). On December 3, 2001, the IPIC court severed all smokeless claims and all smokeless defendants from IPIC. There was no order staying the case during IPIC. In the ensuing 15 years, the plaintiffs in the severed cases did nothing to pursue the cases. The plaintiffs now seek to activate various smokeless claims, including certain plaintiffs whose cases were dismissed in IPIC after severance of the smokeless claims and whose claims are not counted in the 41 claims described above. After a status conference on July 11, 2016, the court set a schedule for briefing the issue of whether the severed claims should be dismissed because of the prolonged inaction in the case. On January 25, 2017, the trial court denied the defendants' motion to dismiss those claims as abandoned. The plaintiffs are now free to move forward with their claims.

Tobacco Buyout Legislation

In 2004, legislation was passed eliminating the U.S. Government's tobacco production controls and price support program. The buyout of tobacco quota holders provided for in the Fair and Equitable Tobacco Reform Act, referred to as FETRA, was funded by a direct quarterly assessment on every tobacco product manufacturer and importer, on a market-share basis measured on volume to which federal excise tax was applied. The aggregate cost of the buyout to the industry was approximately $9.9 billion, including approximately $9.6 billion payable to quota tobacco holders and growers through industry assessments over ten years, into 2014, and approximately $290 million for the liquidation of quota tobacco stock. RAI's operating subsidiaries recorded the FETRA assessment on a quarterly basis as cost of goods sold. RAI's operating subsidiaries' overall share of the buyout approximated $2.5 billion prior to the deduction of permitted offsets under the MSA. The FETRA assessment expired in September 2014.

ERISA Litigation

In May 2002, in *Tatum v. The R.J.R. Pension Investment Committee of the R. J. Reynolds Tobacco Company Capital Investment Plan*, an employee of RJR Tobacco filed a class-action suit in the U.S. District Court for the

Middle District of North Carolina, alleging that the defendants, RJR, RJR Tobacco, the RJR Employee Benefits Committee and the RJR Pension Investment Committee, violated the Employee Retirement Income Security Act of 1974, referred to as ERISA. The actions about which the plaintiff complains stem from a decision made in 1999 by RJR Nabisco Holdings Corp., subsequently renamed Nabisco Group Holdings Corp., referred to as NGH, to spin off RJR, thereby separating NGH's tobacco business and food business. As part of the spin-off, the 401(k) plan for the previously related entities had to be divided into two separate plans for the now separate tobacco and food businesses. The plaintiff contends that the defendants breached their fiduciary duties to participants of the RJR 401(k) plan when the defendants removed the stock funds of the companies involved in the food business, NGH and Nabisco Holdings Corp., referred to as Nabisco, as investment options from the RJR 401(k) plan approximately six months after the spin-off. The plaintiff asserts that a November 1999 amendment (the "1999 Amendment") that eliminated the NGH and Nabisco funds from the RJR 401(k) plan on January 31, 2000, contained sufficient discretion for the defendants to have retained the NGH and Nabisco funds after January 31, 2000, and that the failure to exercise such discretion was a breach of fiduciary duty. In his complaint, the plaintiff requests, among other things, that the court require the defendants to pay as damages to the RJR 401(k) plan an amount equal to the subsequent appreciation that was purportedly lost as a result of the liquidation of the NGH and Nabisco funds.

In July 2002, the defendants filed a motion to dismiss, which the court granted in December 2003. In December 2004, the U.S. Court of Appeals for the Fourth Circuit reversed the dismissal of the complaint, holding that the 1999 Amendment did contain sufficient discretion for the defendants to have retained the NGH and Nabisco funds as of February 1, 2000, and remanded the case for further proceedings. The court granted the plaintiff leave to file an amended complaint and denied all pending motions as moot. In April 2007, the defendants moved to dismiss the amended complaint. The court granted the motion in part and denied it in part, dismissing all claims against the RJR Employee Benefits Committee and the RJR Pension Investment Committee. The plaintiff filed a motion for class certification, which the court granted in September 2008.

A non-jury trial was held in January and February 2010. On February 25, 2013, the district court dismissed the case with prejudice, finding that a hypothetical prudent fiduciary could have made the same decision and thus the plan's loss was not caused by the procedural prudence which the court found to have existed. On August 4, 2014, the Fourth Circuit Court of Appeals, referred to as Fourth Circuit, reversed, holding that the district court applied the wrong standard when it held that the defendants did not cause any loss to the plan, determined the test was whether a hypothetical prudent fiduciary would have made the same decision and remanded the case back to the district court to apply the "would have standard." On February 18, 2016, the district court dismissed the case with prejudice, finding that the defendants have shown by a preponderance of the evidence that a fiduciary acting with prudence would have divested the NGH and Nabisco Funds at the time and in the manner that the defendants did. On March 17, 2016, the plaintiff appealed arguing that the district court erred in finding that a hypothetical prudent fiduciary would have divested the NGH and Nabisco Funds at the same time and in the same manner as RJR. Briefing before the Fourth Circuit is complete. Oral argument occurred on January 25, 2017. A decision is pending.

Environmental Matters

RAI and its subsidiaries are subject to federal, state and local environmental laws and regulations concerning the discharge, storage, handling and disposal of hazardous or toxic substances. Such laws and regulations provide for significant fines, penalties and liabilities, sometimes without regard to whether the owner or operator of the property or facility knew of, or was responsible for, the release or presence of hazardous or toxic substances. In addition, third parties may make claims against owners or operators of properties for personal injuries and property damage associated with releases of hazardous or toxic substances. In the past, RJR Tobacco has been named a potentially responsible party with third parties under the Comprehensive Environmental Response, Compensation and Liability Act with respect to several superfund sites. RAI and its subsidiaries are not aware of any current environmental matters that are expected to have a material adverse effect on the business, results of operations or financial position of RAI or its subsidiaries.

RAI and its operating subsidiaries believe that climate change is an environmental issue primarily driven by carbon dioxide emissions from the use of energy. RAI's operating subsidiaries are working to reduce carbon dioxide emissions by minimizing the use of energy where cost effective, minimizing waste to landfills and increasing recycling. Climate change is not viewed by RAI's operating subsidiaries as a significant direct economic risk to their businesses, but rather an indirect risk involving the potential for a longer-term general increase in the cost of doing business. Regulatory changes are difficult to predict, but the current regulatory risks to the business of RAI's operating subsidiaries with respect to climate change are relatively low. Financial

impacts will be driven more by the cost of natural gas and electricity. Efforts are made to anticipate the effect of increases in fuel costs directly impacting RAI's operating subsidiaries by evaluating natural gas usage and market conditions. Occasionally forward contracts are purchased, limited to a two-year period, for natural gas. In addition, RAI's operating subsidiaries are continually evaluating energy conservation measures and energy efficient equipment to mitigate impacts of increases in energy costs, and adopting or utilizing such measures and equipment where appropriate.

Regulations promulgated by the EPA and other governmental agencies under various statutes have resulted in, and likely will continue to result in, substantial expenditures for pollution control, waste treatment or handling, facility modification and similar activities. RAI and its subsidiaries are engaged in a continuing program to comply with federal, state and local environmental laws and regulations, and dependent upon the probability of occurrence and reasonable estimation of cost, accrue or disclose any material liability. Although it is difficult to reasonably estimate the portion of capital expenditures or other costs attributable to compliance with environmental laws and regulations, RAI does not expect such expenditures or other costs to have a material adverse effect on the business, results of operations, cash flows or financial position of RAI or its subsidiaries.

Shareholder Case

RAI, the members of the RAI board of directors and BAT have been named as defendants in a putative class-action lawsuit captioned *Corwin v. British American Tobacco PLC*, *et al*., brought in North Carolina state court, referred to as the North Carolina Action, by a person identifying himself as a shareholder of RAI. The North Carolina Action was initiated on August 8, 2014, and an amended complaint was filed on November 7, 2014. The amended complaint generally alleges, among other things, that the members of the RAI board of directors breached their fiduciary duties to RAI shareholders by approving the BAT Share Purchase and the sharing of technology with BAT, as well as that there were various conflicts of interest in the transaction. More specifically, the amended complaint alleges that (1) RAI aided and abetted the alleged breaches of fiduciary duties by its board of directors and (2) BAT was a controlling shareholder of RAI and, as a consequence, owed other RAI shareholders fiduciary duties in connection with the BAT Share Purchase. The North Carolina Action seeks injunctive relief, damages and reimbursement of costs, among other remedies. On January 2, 2015, the plaintiff in the North Carolina Action filed a motion for a preliminary injunction seeking to enjoin temporarily the RAI shareholder meeting and votes scheduled for January 28, 2015. RAI and the RAI board of directors timely opposed that motion prior to a hearing that was scheduled to occur on January 16, 2015.

RAI believed that the North Carolina Action was without merit and that no further disclosure was necessary to supplement the Joint Proxy Statement/Prospectus under applicable laws. However, to eliminate certain burdens, expenses and uncertainties, on January 17, 2015, RAI and the director defendants in the North Carolina Action entered into the North Carolina Memorandum of Understanding regarding the settlement of the disclosure claims asserted in that lawsuit. The North Carolina Memorandum of Understanding outlines the terms of the parties' agreement in principle to settle and release the disclosure claims which were or could have been asserted in the North Carolina Action. In consideration of the partial settlement and release, RAI agreed to make certain supplemental disclosures to the Joint Proxy Statement/Prospectus, which it did on January 20, 2015. On August 4, 2015, the trial court granted the defendants' motions to dismiss all of the remaining non-disclosure claims. The plaintiff appealed. On February 17, 2016, the trial court approved the partial settlement, including the plaintiff's unopposed request for $415,000 in attorneys' fees and costs. The partial settlement did not affect the consideration paid to Lorillard shareholders in connection with the Lorillard Merger. On December 20, 2016, the North Carolina Court of Appeals affirmed the trial court's dismissal of the claims against RAI and RAI's Board of Directors on the grounds that the plaintiff could not state a direct claim against RAI's Board of Directors for breach of fiduciary duties. The Court of Appeals reversed the dismissal of the claims against BAT. On January 4, 2017, BAT filed a motion for rehearing *en banc* of the Court of Appeals' opinion, which was denied on February 2, 2017.

Other Contingencies

JTI Indemnities. In connection with the sale of the international tobacco business to JTI, pursuant to the 1999 Purchase Agreement, RJR and RJR Tobacco agreed to indemnify JTI against:

- any liabilities, costs and expenses arising out of the imposition or assessment of any tax with respect to the international tobacco business arising prior to the sale, other than as reflected on the closing balance sheet;

- any liabilities, costs and expenses that JTI or any of its affiliates, including the acquired entities, may incur after the sale with respect to any of RJR's or RJR Tobacco's employee benefit and welfare plans; and
- any liabilities, costs and expenses incurred by JTI or any of its affiliates arising out of certain activities of Northern Brands.

As described above in "— Litigation Affecting the Cigarette Industry — Other Litigation and Developments — JTI Claims for Indemnification," RJR Tobacco has received claims for indemnification from JTI, and several of these have been resolved. Although RJR and RJR Tobacco recognize that, under certain circumstances, they may have other unresolved indemnification obligations to JTI under the 1999 Purchase Agreement, RJR and RJR Tobacco disagree what circumstances described in such claims give rise to any indemnification obligations by RJR and RJR Tobacco and the nature and extent of any such obligation. RJR and RJR Tobacco have conveyed their position to JTI, and the parties have agreed to resolve their differences at a later date.

In connection with the sale of the international rights to the NATURAL AMERICAN SPIRIT brand name and associated trademarks to JTI Holding, along with the international companies that distribute and market the brand outside the United States, pursuant to the 2015 Purchase Agreement, SFNTC, R. J. Reynolds Global Products, Inc., and R. J. Reynolds Tobacco B.V. agreed to indemnify JTI Holding against, among other things, any liabilities, costs, and expenses relating to actions:

- commenced on or before (1) January 13, 2019, to the extent relating to alleged personal injuries, and (2) in all other cases, January 13, 2021;
- brought by (1) a governmental authority to enforce legislation implementing European Union Directive 2001/37/EC or European Directive 2014/40/EU or (2) consumers or a consumer association; and
- arising out of any statement or claim (1) made on or before January 13, 2016, (2) by any company sold to JTI Holding in the transaction, (3) concerning NATURAL AMERICAN SPIRIT brand products consumed or intended to be consumed outside of the United States and (4) that the NATURAL AMERICAN SPIRIT brand product is natural, organic, or additive free.

ITG Indemnity. In the purchase agreement relating to the Divestiture, RAI agreed to defend and indemnify, subject to certain conditions and limitations, ITG in connection with claims relating to the purchase or use of one or more of the WINSTON, KOOL, SALEM, or MAVERICK cigarette brands on or before June 12, 2015, as well as in actions filed before June 13, 2023, relating to the purchase or use of one or more of the WINSTON, KOOL, SALEM, or MAVERICK cigarette brands. In the purchase agreement relating to the Divestiture, ITG agreed to defend and indemnify, subject to certain conditions and limitations, RAI and its affiliates in connection with claims relating to the purchase or use of blu brand e-cigarettes. ITG also agreed to defend and indemnify, subject to certain conditions and limitations, RAI and its affiliates in actions filed after June 12, 2023, relating to the purchase or use of one or more of the WINSTON, KOOL, SALEM, or MAVERICK cigarette brands after June 12, 2015.

Loews Indemnity. In 2008, Loews Corporation, referred to as Loews, entered into an agreement with Lorillard, Lorillard Tobacco, and certain of their affiliates, which agreement is referred to as the Separation Agreement. In the Separation Agreement, Lorillard agreed to indemnify Loews and its officers, directors, employees and agents against all costs and expenses arising out of third party claims (including, without limitation, attorneys' fees, interest, penalties and costs of investigation or preparation of defense), judgments, fines, losses, claims, damages, liabilities, taxes, demands, assessments, and amounts paid in settlement based on, arising out of or resulting from, among other things, Loews's ownership of or the operation of Lorillard and its assets and properties, and its operation or conduct of its businesses at any time prior to or following the separation of Lorillard and Loews (including with respect to any product liability claims). Loews is a defendant in three pending product liability actions, each of which is a putative class action. Pursuant to the Separation Agreement, Lorillard is required to indemnify Loews for the amount of any losses and any legal or other fees with respect to such cases. Following the closing of the Lorillard Merger, RJR Tobacco assumed Lorillard's obligations under the Separation Agreement as was required under the Separation Agreement.

Indemnification of Distributors and Retailers. RJR Tobacco, Lorillard Tobacco, SFNTC, American Snuff Co. and RJR Vapor have entered into agreements to indemnify certain distributors and retailers from liability and related defense costs arising out of the sale or distribution of their products. Additionally, SFNTC has entered into an agreement to indemnify a supplier from liability and related defense costs arising out of the sale or use of

SFNTC's products. The cost has been, and is expected to be, insignificant. RJR Tobacco, SFNTC, American Snuff Co. and RJR Vapor believe that the indemnified claims are substantially similar in nature and extent to the claims that they are already exposed to by virtue of their having manufactured those products.

Except as otherwise noted above, RAI is not able to estimate the maximum potential amount of future payments, if any, related to these indemnification obligations.

Lease Commitments

RAI has operating lease agreements that are primarily for automobiles, office space, warehouse space and equipment. The majority of these leases expire within the next five years and some contain renewal or purchase options and escalation clauses or restrictions to subleases. Total rent expense was $27 million, $26 million and $25 million for 2016, 2015 and 2014, respectively.

Future minimum lease payments as of December 31, 2016 (in millions) were as follows:

	Noncancellable Operating Leases
2017	$20
2018	3
2019	2
2020	1
2021	1
Total	$27

Note 14 — Shareholders' Equity

RAI's authorized capital stock at December 31, 2016 and 2015, consisted of 100 million shares of preferred stock, par value $.01 per share, and 3.2 billion shares of common stock, par value $.0001 per share. Four million shares of the preferred stock are designated as Series A Junior Participating Preferred Stock, none of which is issued or outstanding. The Series A Junior Participating Preferred Stock will rank junior as to dividends and upon liquidation to all other series of RAI preferred stock, unless specified otherwise. Also, of the preferred stock, one million shares are designated as Series B Preferred Stock, all of which are issued and outstanding. The Series B Preferred Stock ranks senior upon liquidation, but not with respect to dividends, to all other series of RAI capital stock, unless specified otherwise. As a part of the B&W business combination, RJR is the holder of the outstanding Series B Preferred Stock. In each of 2016, 2015 and 2014, RAI declared $43 million in dividends to RJR with respect to the Series B Preferred Stock.

RAI's board of directors declared the following quarterly cash dividends per share of RAI common stock in 2016, 2015 and 2014:

	2016	2015	2014
First	$0.42	$0.335	$0.335
Second	0.42	0.335	0.335
Third	0.46	0.360	0.335
Fourth	0.46	0.360	0.335

Accumulated Other Comprehensive Income (Loss)

The components of accumulated other comprehensive loss, net of tax, were as follows:

	Retirement Benefits	Long-Term Investments	Hedging Instruments	Cumulative Translation Adjustment and Other	Total
Balance at December 31, 2014	$(294)	$(14)	$(12)	$(44)	$(364)
Other comprehensive income before reclassifications	(78)	—	—	(25)	(103)
Amounts reclassified from accumulated other comprehensive income (loss)	128	—	1	—	129
Net current-period other comprehensive income	50	—	1	(25)	26
Balance at December 31, 2015	(244)	(14)	(11)	(69)	(338)
Other comprehensive income before reclassifications	(18)	—	—	(17)	(35)
Amounts reclassified from accumulated other comprehensive income (loss)	7	14	11	27	59
Net current-period other comprehensive income	(11)	14	11	10	24
Balance at December 31, 2016	$(255)	$ —	$ —	$(59)	$(314)

Details about the reclassifications out of accumulated other comprehensive loss and the affected line items in the consolidated statements of income for the years ended December 31, 2016, 2015 and 2014, were as follows:

	Amounts Reclassified			
Components	2016	2015	2014	Affected Line Item
Retirement benefits:				
Amortization of prior service cost	$(20)	$ (20)	$ (21)	Cost of products sold
Amortization of prior service cost	(19)	(19)	(18)	Selling, general and administrative expenses
Settlement cost	2	—	—	Selling, general and administrative expenses
MTM adjustment	21	120	205	Cost of products sold
MTM adjustment	24	126	247	Selling, general and administrative expenses
	8	207	413	Operating income
Deferred taxes	(1)	(79)	(162)	Provision for income taxes
Net of tax	7	128	251	Net income
Long-term investments:				
Realized loss, net on long-term investments	24	—	—	Other (income) expense, net
Deferred taxes	(10)	—	—	Provision for income taxes
Net of tax	14	—	—	Net income
Hedging instruments:				
Forward starting interest rate contracts	16	—	—	Other (income) expense, net
Amortization of realized loss	1	2	2	Interest and debt expense
	17	2	2	Income from continuing operations before income taxes
Deferred taxes	(6)	(1)	(1)	Provision for income taxes
Net of tax	11	1	1	Net income
Cumulative translation adjustment and other:				
Derecognition of cumulative translation adjustment	27	—	—	Gain on divestitures
Total reclassifications	$ 59	$129	$ 252	Net income

Share Repurchases and Other

In November 2011, RAI, B&W and BAT entered into Amendment No. 3 to the governance agreement dated as of July 30, 2004, as amended, referred to as the Governance Agreement, pursuant to which RAI has agreed that, so long as the beneficial ownership interest of BAT and its subsidiaries in RAI has not dropped below 25%, if RAI issues shares of its common stock or any other RAI equity security to certain designated persons, including its directors, officers or employees, then RAI will repurchase a number of shares of outstanding RAI common stock so that the number of outstanding shares of RAI common stock are not increased, and the beneficial ownership interest of BAT and its subsidiaries in RAI is not decreased, by such issuance after taking into account such repurchase. During 2016, RAI repurchased and cancelled 1,817,846 shares of RAI common stock for $93 million in accordance with the Governance Agreement.

Restricted stock units granted in March 2013, May 2015, September 2014 and January 2016 under the Amended and Restated Omnibus Incentive Compensation Plan, referred to as the Omnibus Plan, vested in March 2016, May 2016, September 2016 and December 2016, respectively, and were settled with the issuance of 2,938,567 shares of RAI common stock. In addition, during the year ended December 31, 2016, at a cost of $58 million, RAI purchased 1,146,978 shares of RAI common stock that were forfeited and cancelled with respect to tax liabilities associated with restricted stock units vesting under the Omnibus Plan.

On July 25, 2016, the board of directors of RAI authorized the repurchase, from time to time, on or before December 31, 2018, of up to $2 billion of outstanding shares of RAI common stock in open-market or privately negotiated transactions, referred to as the Share Repurchase Program. The purchases are subject to prevailing market and business conditions, and the program may be terminated or suspended at any time. In connection with the Share Repurchase Program, B&W and Louisville Securities Limited, referred to as LSL, wholly owned subsidiaries of BAT, entered into an agreement, referred to as the Share Repurchase Agreement, with RAI, pursuant to which BAT and its subsidiaries will participate in the Share Repurchase Program on a basis approximately proportionate with BAT and its subsidiaries' ownership of RAI's common stock. During 2016, RAI repurchased 1,565,698 shares of RAI common stock for $75 million in accordance with the Share Repurchase Program. The Merger Agreement places restrictions on RAI's ability to repurchase its common stock. As a result, RAI does not expect to make repurchases under the Share Repurchase Program while the Merger Agreement is in effect.

Due to RAI's incorporation in North Carolina, which does not recognize treasury shares, the shares repurchased were cancelled at the time of repurchase.

Changes in RAI common stock outstanding were as follows:

	2016	2015	2014
Shares outstanding at beginning of year	1,427,341,341	1,062,567,026	1,076,106,048
Omnibus Plan tax shares repurchased and cancelled	(1,146,978)	(1,111,835)	(1,108,084)
Omnibus Plan shares issued from vesting of restricted stock units	2,938,567	2,870,927	2,936,588
Issuance of additional shares as Lorillard Merger Consideration	—	209,413,694	—
Issuance of additional shares for BAT Share Purchase	—	155,360,518	—
Shares repurchased and cancelled	(3,383,544)	(1,822,197)	(15,431,526)
Equity incentive award plan shares issued	75,569	63,208	64,000
Shares outstanding at end of year	1,425,824,955	1,427,341,341	1,062,567,026

Note 15 — Stock Plans

As of December 31, 2016, RAI had two stock plans, the Equity Incentive Award Plan for Directors of RAI, referred to as the EIAP, and the Omnibus Plan.

Under the EIAP, RAI currently provides grants of deferred stock units to eligible directors on a quarterly and annual basis, with the annual grant being made generally on the date of RAI's annual shareholders' meeting. Prior to September 13, 2012, upon election to RAI's board of directors, an eligible director received an initial grant of 3,500 deferred stock units under the EIAP. After September 13, 2012, grants are no longer made to directors upon their initial election to the board of directors, but eligible directors initially elected to RAI's board of directors after such date on a date other than the annual meeting date, and who, therefore, are not eligible to receive the annual stock award for such year, now receive a pro rata portion of the annual award upon election. Directors may elect to receive shares of common stock in lieu of their initial and annual grants of deferred stock

units. A maximum of 4,000,000 shares, subject to anti-dilution adjustments, of common stock may be issued under this plan, of which 1,904,424 shares were available for grant as of December 31, 2016. Deferred stock units granted under the EIAP have a value equal to, and bear dividend equivalents at the same rate as, one share of RAI common stock, and have no voting rights. The dividends are paid as additional units in an amount equal to the number of shares of RAI common stock that could be purchased with the dividends on the date of payment. Generally, distribution of a director's deferred stock units will be made on January 2 following his or her last year of service on the board; however, for all grants made under the EIAP after December 31, 2007, a director may elect to receive his or her deferred stock units on the later of January 2 of a specified year or January 2 following his or her last year of service on the board. At the election of a director, distribution may be made in one lump sum or in up to ten annual installments. A director is paid in cash for the units granted quarterly and in common stock for the units granted initially and annually, unless the director elects to receive cash for the initial and annual grants. Cash payments are based on the average closing price of RAI common stock during December of the year preceding payment. Compensation expense related to the EIAP was $14 million, $15 million and $10 million during 2016, 2015 and 2014, respectively.

Awards to key employees under the Omnibus Plan may be in the form of cash awards, incentive or non-incentive stock options, stock appreciation rights, restricted stock, restricted stock units, performance shares, performance units or other awards. Subject to adjustments as set forth in the Omnibus Plan, the number of shares of RAI common stock that may be issued with respect to awards under the Omnibus Plan will not exceed 76,000,000 shares in the aggregate. Upon retirement, a holder's grant under the Omnibus Plan generally vests on a pro rata basis for the portion of the vesting service period that has elapsed, thereby maintaining an appropriate approximation of forfeitures related to retirement.

Information regarding restricted stock unit awards outstanding as of December 31, 2016, under the Omnibus Plan was as follows:

Grant Year	Number of Shares Granted	Grant Price Per Share	Vesting Date	Number of Shares Cancelled and Vested	Cumulative Dividends Per Share	Ending Date of Performance Period
Three-year grants						
2014	2,098,696	$ 26.645	March 3, 2017	504,776	$ 4.02	December 31, 2016
2014	51,814	$ 29.365	March 3, 2017	—	$ 3.02	December 31, 2016
2015	1,386,180	$ 37.940	March 2, 2018	169,217	$ 4.02	December 31, 2017
2015	17,196	$ 36.300	March 2, 2018	—	$ 4.02	December 31, 2017
2016	1,071,544	$ 50.490	March 1, 2019	83,454	$ 5.04	December 31, 2018
2016	4,898	$ 50.130	March 1, 2019	—	$ 4.62	December 31, 2018
2016	1,727	$ 51.030	March 1, 2019	—	$ 4.20	December 31, 2018
2016	4,581	$ 50.550	March 1, 2019	—	$ 4.20	December 31, 2018
2016	21,249	$ 55.100	March 1, 2019	—	$ 3.78	December 31, 2018
2016	1,366	$ 56.040	March 1, 2019	—	$ 3.36	December 31, 2018
One-year grant						
2016	164,841	$ 56.040	May 1, 2017	—	$ 1.68	April 30, 2017
Other grants						
2014	74,266	$ 29.365	September 30, 2018	—	N/A	N/A
2016	23,605	$ 46.930	December 15, 2017	—	N/A	N/A
2016	16,094	$ 46.930	December 15, 2018	—	N/A	N/A
2016	10,551	$ 55.100	December 15, 2017	—	N/A	N/A
2016	10,550	$ 55.100	December 15, 2018	—	N/A	N/A

Three-Year Grants and Other Grants

The grant date fair value was based on the per share closing price of RAI common stock on the date of grant. The actual number of shares granted is fixed. As an equity-based grant, compensation expense includes the vesting period lapsed. There were no shares issued during 2016 with respect to awards outstanding as of December 31, 2016. All outstanding grants will be settled exclusively in RAI common stock.

Upon settlement, each grantee of the three-year grants will receive a number of shares of RAI's common stock equal to the product of the number of vested units and a percentage up to 150% based on the average RAI annual incentive award plan score over the three-year period ending on December 31 of the year prior to the vesting date. The other grants do not contain a performance measure.

One-Year Grant

The actual number of shares granted is fixed. As an equity-based grant, compensation expense will take into account the vesting period lapsed and will be calculated based on the per share closing price of RAI common stock as of the end of each quarter, which was $56.04 as of December 31, 2016. There were no shares issued during 2016 with respect to awards outstanding as of December 31, 2016. All outstanding grants will be settled exclusively in RAI common stock.

Upon settlement, the grantee will receive a number of shares of RAI's common stock equal to the product of the number of vested units and a percentage up to 200% based on the overall performance of RAI and its subsidiaries during the one-year performance period beginning May 1, 2016, and ending April 30, 2017, against RAI's 2016 annual incentive award program metrics and other performance factors.

Restricted Stock Unit Dividends

Dividends paid on shares of RAI common stock will accumulate on the restricted stock units and be paid to the grantee on the vesting date. If RAI fails to pay its shareholders cumulative dividends of at least the amounts shown above, then each award will be reduced by an amount equal to three times the percentage of the dividend underpayment, up to a maximum reduction of 50%. Dividends are accrued on the grants and included in other current liabilities, based on the vesting date of less than one year, and in other noncurrent liabilities, based on the vesting date of greater than one year, in the consolidated balance sheets as of December 31, 2016 and 2015.

The changes in the number of RAI restricted stock units during 2016 were as follows:

	Number of Stock Units	Weighted Average Grant Date Fair Value Per Share
Outstanding at beginning of year	5,147,400	$28.42
Granted	1,354,611	51.15
Forfeited	(224,490)	39.21
Vested	(2,075,810)	25.11
Outstanding at end of year	4,201,711	36.81

Total compensation expense related to stock-based compensation and the related tax benefits recognized in selling, general and administrative expenses in the consolidated statements of income as of December 31, were as follows:

Grant/Type	2016	2015	2014
2011 restricted stock units	$—	$—	$ 3
2012 restricted stock units	—	3	14
2013 restricted stock units	3	20	15
2014 restricted stock units	20	32	24
2015 restricted stock units	30	24	—
2016 restricted stock units	24	—	—
Total compensation expense	$77	$79	$56
Total related tax benefits	$27	$28	$20

The amounts related to the unvested Omnibus Plan restricted stock unit grants included in the consolidated balance sheets as of December 31, were as follows:

	2016	2015
Other current liabilities	$ 10	$ 10
Other noncurrent liabilities	7	8
Paid-in capital	111	110

As of December 31, 2016, there were $63 million of unrecognized compensation costs related to restricted stock units, calculated at the grant-date price, which are expected to be recognized over a weighted-average period of 1.7 years. The excess tax benefits related to stock-based compensation were $28 million, $17 million and $12 million in 2016, 2015 and 2014, respectively.

There are no outstanding options under the EIAP or the Omnibus Plan, and as a result there was no share option activity during 2016 and 2015.

Equity compensation plan information as of December 31, 2016, was as follows:

Plan Category	Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights	Weighted Average Exercise Price of Outstanding Options, Warrants and Rights	Number of Securities Remaining Available for Future Issuance under Equity Compensation Plans (Excluding Securities Reflected in Column (a))
	(a)	(b)	(c)
Equity Compensation Plans Approved by Security Holders	6,317,451(2)	$—	62,307,352
Equity Compensation Plans Not Approved by Security Holders (1)	—	—	1,904,424
Total	6,317,451(2)	—	64,211,776

(1) The EIAP was approved by RJR's sole shareholder, Nabisco Group Holdings Corp., prior to RJR's spin-off on June 15, 1999.

(2) Consists of restricted stock units. These restricted stock units represent the maximum number of shares to be awarded under the best-case targets, and accordingly, may overstate expected dilution.

Note 16 — Retirement Benefits

Pension and Postretirement Benefit Plans

RAI sponsors a number of non-contributory defined benefit pension plans covering certain employees of RAI and its subsidiaries. RAI and a subsidiary provide health and life insurance benefits for certain retired employees of RAI and its subsidiaries and their dependents. These benefits are generally no longer provided to employees hired on or after January 1, 2004.

The changes in benefit obligations and plan assets, as well as the funded status of these plans at December 31 were as follows:

	Pension Benefits		Postretirement Benefits	
	2016	2015	2016	2015
Change in benefit obligations:				
Obligations at beginning of year	$ 6,738	$ 6,389	$1,210	$1,251
Service cost	16	26	2	2
Interest cost	295	275	49	50
Actuarial (gain) loss	95	(270)	(12)	(120)
Merger	—	756	—	111
Benefits paid	(434)	(431)	(87)	(84)
Settlements	(36)	(7)	—	—
Obligations at end of year	$ 6,674	$ 6,738	$1,162	$1,210
Change in plan assets:				
Fair value of plan assets at beginning of year	$ 5,351	$ 5,309	$ 241	$ 259
Actual return on plan assets	432	(131)	10	(1)
Employer contributions	335	18	66	67
Merger	—	593	—	—
Benefits paid	(434)	(431)	(87)	(84)
Settlements	(36)	(7)	—	—
Fair value of plan assets at end of year	$ 5,648	$ 5,351	$ 230	$ 241
Funded status	$(1,026)	$(1,387)	$ (932)	$ (969)

For the pension benefit plans, the benefit obligation is the projected benefit obligation. For the postretirement benefit plans, the benefit obligation is the accumulated postretirement benefit obligation.

As of December 31, 2016, the improvement in pension benefits funded status is primarily due to employer contributions, updated mortality and other assumptions and higher return on plan assets partially offset by the decrease in the discount rate.

As of December 31, 2016, the improvement in postretirement benefits funded status is primarily due to updated mortality and health-care claims assumptions offset by the decrease in the discount rate.

As of December 31, 2015, the decline in pension benefits funded status is primarily a result of the acquired plans from the Lorillard Merger, lower return on plan assets, and updated assumptions offset by the increase in the discount rate.

As of December 31, 2015, the improvement in postretirement benefits funded status is primarily a result of the increase in the discount rate and updated assumptions offset by the acquired plans from the Lorillard Merger.

The changes in net actuarial (gain) loss impacted the funded status as follows:

	Pension Benefits		Postretirement Benefits	
	2016	2015	2016	2015
Net actuarial (gain) loss:				
Change in discount rate	$ 266	$(287)	$ 38	$ (37)
Change in mortality table	(101)	(128)	(14)	(21)
Actual return on plan assets	(432)	131	(10)	1
Expected return on plan assets	372	373	12	12
Other	(69)	145	(37)	(62)
Net actuarial (gain) loss	$ 36	$ 234	$(11)	$(107)

	Pension Benefits		Postretirement Benefits	
	2016	2015	2016	2015
Amounts recognized in the consolidated balance sheets consist of:				
Accrued benefit — other current liabilities	$ (11)	$ (10)	$ (78)	$ (81)
Accrued benefit — long-term retirement benefits	(1,015)	(1,377)	(854)	(888)
Net amount recognized	(1,026)	(1,387)	(932)	(969)
Accumulated other comprehensive loss	616	636	(146)	(183)
Net amounts recognized in the consolidated balance sheets	$ (410)	$ (751)	$(1,078)	$(1,152)

Amounts included in accumulated other comprehensive loss were as follows as of December 31:

	2016			2015		
	Pension Benefits	Postretirement Benefits	Total	Pension Benefits	Postretirement Benefits	Total
Prior service cost (credit)	$ 7	$ (95)	$ (88)	$ 10	$(137)	$(127)
Net actuarial (gain) loss	609	(51)	558	626	(46)	580
Deferred income taxes	(256)	41	(215)	(262)	53	(209)
Accumulated other comprehensive loss	$ 360	$(105)	$ 255	$ 374	$(130)	$ 244

Changes in accumulated other comprehensive loss were as follows:

	2016			2015		
	Pension Benefits	Postretirement Benefits	Total	Pension Benefits	Postretirement Benefits	Total
Net actuarial (gain) loss	$ 36	$(11)	$ 25	$ 234	$(107)	$ 127
Amortization of prior service cost (credit)	(3)	42	39	(3)	42	39
Prior service cost (credit)	—	—	—	—	(1)	(1)
Settlement cost	(2)	—	(2)	(1)	—	(1)
MTM adjustment	(51)	6	(45)	(246)	—	(246)
Deferred income tax (benefit) expense	6	(12)	(6)	6	26	32
Change in accumulated other comprehensive loss	$(14)	$ 25	$ 11	$ (10)	$ (40)	$ (50)

The pension MTM adjustment expense in 2016 is primarily a result of a decrease in the discount rate and was partially offset by pension asset return gains of $432 million versus an expected return of $372 million and updated mortality and other assumptions. The postretirement MTM adjustment gain in 2016 is primarily a result of updated mortality and health-care claims assumptions and was partially offset by a decrease in the discount rate.

The MTM adjustment expense in 2015 is primarily a result of pension asset return losses of $131 million versus an expected return of $373 million and was partially offset by an increase in the discount rate.

In March 2010, the Patient Protection Affordable Care Act, referred to as the PPACA, as amended by the Health Care and Reconciliation Act of 2010, was signed into law. The PPACA mandates health-care reforms with staggered effective dates from 2010 to 2018. The additional postretirement liability resulting from the material impacts of the PPACA have been included in the accumulated postretirement benefit obligation at December 31, 2016 and 2015. Given the complexity of the PPACA and the extended time period in which implementation is expected to occur, further adjustments to the accumulated postretirement benefit obligation may be necessary in the future.

	Pension Benefits		Postretirement Benefits	
	2016	2015	2016	2015
Weighted-average assumptions used to determine benefit obligations at December 31:				
Discount rate	4.16%	4.54%	4.12%	4.47%
Rate of compensation increase	4.00%	4.00%	—	—

The measurement date used for all plans was December 31.

Pension plans experiencing accumulated benefit obligations, which represent benefits earned to date, in excess of plan assets are summarized below:

	December 31,	
	2016	2015
Projected benefit obligation	$6,674	$6,738
Accumulated benefit obligation	6,625	6,684
Plan assets	5,648	5,351

The components of the total benefit cost (income) and assumptions are set forth below:

	Pension Benefits			Postretirement Benefits		
	2016	2015	2014	2016	2015	2014
Service cost	$ 16	$ 26	$ 21	2	2	$ 2
Interest cost	295	275	266	49	50	53
Expected return on plan assets	(372)	(373)	(360)	(12)	(12)	(12)
Amortization of prior service cost (credit)	3	3	3	(42)	(42)	(42)
Settlements	2	1	—	—	—	—
MTM adjustment	51	246	420	(6)	—	32
Total benefit cost (income)	$ (5)	$ 178	$ 350	$ (9)	$ (2)	$ 33

The estimated amortization of prior service cost for the pension plans is expected to be $3 million during 2017. The estimated amortization of prior service credit for the postretirement plans is expected to be $36 million during 2017.

	Pension Benefits			Postretirement Benefits		
	2016	2015(1)	2014	2016	2015 (1)	2014
Weighted-average assumptions used to determine net periodic benefit cost for years ended December 31:						
Discount rate	4.54%	4.14%	4.92%	4.47%	4.12%	4.87%
Expected long-term return on plan assets	6.82%	6.83%	7.13%	4.60%	4.85%	4.85%
Rate of compensation increase	4.00%	4.00%	4.00%	—	—	—

(1) Determined as of the beginning of year and adjusted for the Lorillard Merger in 2015.

Additional information relating to RAI's significant postretirement plans is as follows:

	2016	2015
Weighted-average health-care cost trend rate assumed for the following year	7.00%	7.00%
Rate to which the cost trend rate is assumed to decline (the ultimate trend rate)	5.00%	5.00%
Year that the rate reaches the ultimate trend rate	2025	2020

Assumed health-care cost trend rates have a significant effect on the amounts reported for the health-care plans. A one-percentage-point change in assumed health-care cost trend rates would have had the following effects at December 31, 2016:

	1-Percentage Point Increase	1-Percentage Point Decrease
Effect on total of service and interest cost components	$ 2	$ (2)
Effect on benefit obligation	58	(49)

During 2017, RAI expects to contribute $111 million to its pension plans and $78 million to its postretirement plans.

Estimated future benefit payments:

		Postretirement Benefits		
Year	Pension Benefits	Gross Projected Benefit Payments Before Medicare Part D Subsidies	Expected Medicare Part D Subsidies	Net Projected Benefit Payments After Medicare Part D Subsidies
2017	$ 447	$105	$ (2)	$103
2018	443	90	(2)	88
2019	439	87	(2)	85
2020	436	85	(2)	83
2021	431	83	(2)	81
2022-2026	2,082	386	(11)	375

Pension and Postretirement Assets

RAI generally uses a hypothetical bond matching analysis to determine the discount rate. The discount rate modeling process involves selecting a portfolio of high quality corporate bonds whose cash flows, via coupons and maturities, match the projected cash flows of the obligations.

The overall expected long-term rate of return on asset assumptions for pension and postretirement assets are based on: (1) the target asset allocation for plan assets, (2) long-term capital markets forecasts for asset classes employed, and (3) excess return expectations of active management to the extent asset classes are actively managed.

Plan assets are invested using active investment strategies and multiple investment management firms. Managers within each asset class cover a range of investment styles and approaches and are combined in a way that controls for capitalization, style bias, and interest rate exposures, while focusing primarily on security selection as a means to add value. Risk is controlled through diversification among asset classes, managers, investment styles and securities. Risk is further controlled both at the manager and asset class level by assigning excess return and tracking error targets against related benchmark indices. Investment manager performance is evaluated against these targets.

RAI employs a risk mitigation strategy, which seeks to balance pension plan returns with a reasonable level of funded status volatility. Based on this framework, the asset allocation has two primary components. The first component is the "hedging portfolio," which uses extended duration fixed income holdings and derivatives to match a portion of the interest rate risk associated with the benefit obligations, thereby reducing expected funded status volatility. The second component is the "return seeking portfolio," which is designed to enhance portfolio returns. The return seeking portfolio is broadly diversified across asset classes.

Allowable investment types include domestic equity, international equity, global equity, emerging market equity, fixed income, real assets, private equity, absolute return and commodities. The range of allowable investment types utilized for pension assets provides enhanced returns and more widely diversifies the plan.

Domestic equities are composed of common stocks of large, medium and small companies. International equities include equity securities issued by companies domiciled outside the United States and in depository receipts, which represent ownership of securities of non-U.S. companies. Global equities include a combination of both domestic and international equities. Emerging market equities are comprised of stocks that are domiciled in less developed, fast growing countries. Fixed income includes corporate debt obligations, fixed income securities issued or guaranteed by the U.S. government, and to a lesser extent by non-U.S. governments, mortgage backed securities, high yield securities, asset backed securities, municipal bonds and dollar-denominated obligations issued in the United States by non-U.S. banks and corporations. Real assets consist of publicly traded real estate investment trust securities, private real estate investments and private energy investments. Private equity consists of the unregistered securities of private and public companies. Absolute return investments are diversified portfolios utilizing multiple strategies that invest primarily in public securities, including equities and fixed income. Commodities utilize futures contracts to invest in a variety of energy, metal and agricultural goods.

For pension assets, futures and forward contracts are used for portfolio rebalancing and to approach fully invested portfolio positions. Otherwise, a small number of investment managers employ limited use of derivatives, including futures contracts, options on futures, forward contracts and interest rate swaps in place of direct investment in securities to gain efficient exposure to markets.

RAI's pension and postretirement plans asset allocations at December 31, 2016 and 2015, by asset category were as follows:

	Pension Plans			
	2016 Target (1)	2016	2015 Target (1)	2015
Asset Category:				
Domestic equities	10%	12%	10%	10%
International equities	8%	8%	8%	7%
Global equities	9%	12%	9%	11%
Emerging market equities	3%	2%	3%	2%
Fixed income	53%	53%	53%	53%
Absolute return	6%	7%	6%	8%
Private equity	2%	2%	2%	2%
Real assets	5%	4%	5%	5%
Commodities	4%	—	4%	2%
Total	100%	100%	100%	100%

	Postretirement Plans			
	2016 Target (1)	2016	2015 Target (1)	2015
Asset Category:				
Domestic equities	21%	22%	21%	20%
International equities	21%	20%	21%	21%
Fixed income	55%	51%	55%	54%
Cash and other	3%	7%	3%	5%
Total	100%	100%	100%	100%

(1) Allows for a rebalancing range of up to 5 percentage points around target asset allocations.

RAI's pension and postretirement plan assets, excluding uninvested cash and unsettled trades, carried at fair value on a recurring basis as of December 31, 2016 and 2015, were as follows [(1)]:

Pension Plans	2016 Level 1	2016 Level 2	2016 Level 3	2016 Total	2015 Level 1	2015 Level 2	2015 Level 3	2015 Total
Asset Category:								
Domestic equities	$ 457	$ —	$—	$ 457	$ 410	$ —	$—	$ 410
Global equities	635	—	—	635	585	—	—	585
International equities	137	—	—	137	144	—	—	144
Real assets	23	—	—	23	21	—	—	21
Agency bonds	—	29	—	29	—	18	—	18
Asset backed securities	—	52	1	53	—	90	3	93
Corporate bonds	—	1,797	1	1,798	—	1,718	1	1,719
Government bonds	—	78	—	78	—	91	—	91
High yield fixed income	—	20	—	20	—	19	—	19
Mortgage backed securities	—	75	—	75	—	41	—	41
Municipal bonds	—	201	—	201	—	201	—	201
Treasuries	—	554	—	554	—	550	—	550
Cash equivalents and other	28	332	2	362	33	90	2	125
Total investments in the fair value hierarchy	$1,280	$3,138	$ 4	4,422	$1,193	$2,818	$ 6	4,017
Investments measured at net asset value [(2)]				1,250				1,282
Total				$5,672				$5,299

Postretirement Plans	2016 Level 1	2016 Level 2	2016 Level 3	2016 Total	2015 Level 1	2015 Level 2	2015 Level 3	2015 Total
Asset Category:								
Short-term bonds	$ 8	$—	$—	$ 8	$13	$—	$—	$ 13
Cash equivalents and other	—	7	—	7	—	6	—	6
Total investments in the fair value hierarchy	$ 8	$ 7	$—	15	$13	$ 6	$—	19
Investments measured at net asset value (2)				205				216
Total				$220				$235

(1) See note 1 for additional information on the fair value hierarchy.

(2) Prior-year amounts were reclassified in accordance with the adoption of ASU 2015-07.

For the years ended December 31, 2016 and 2015, there were no transfers among the fair value hierarchy levels.

At December 31, 2016 and 2015, the fair value of pension and postretirement assets classified as Level 1 was determined using a combination of third party pricing services for certain domestic equities, global equities, international equities, real assets and cash equivalents and other.

At December 31, 2016 and 2015, the fair value of pension and postretirement assets classified as Level 2 was determined using a combination of third party pricing services for certain agency bonds, asset backed securities, corporate bonds, government bonds, high yield fixed income, mortgage backed securities, municipal bonds, treasuries and cash equivalents and other.

The fair value of assets classified as asset backed securities, corporate bonds and other, classified as Level 3, was determined primarily using an income approach that utilized cash flow models and benchmarking strategies. This approach utilized inputs, including market-based interest rate curves, corporate credit spreads and corporate ratings. Additionally, unobservable factors incorporated into these models included default probability assumptions, potential recovery, discount rates and other entity specific factors.

In instances where the plans have invested in commingled pools, the net asset value was used as the practical expedient and no adjustments were made to the provided fair value. This approach utilized the net asset value of the underlying investment fund adjusted by the investment manager for restrictions or illiquidity of the disposition of the interest, if any, valuations provided by the fund's cash flows, and the rights and obligations of the ownership interest of the fund.

Transfers of pension and postretirement plan assets in and out of Level 3 during 2016, by asset category were as follows (1) :

	Balance as of January 1, 2016	Purchases, Sales, Issuances and Settlements (net)	Realized Gains (Losses)	Unrealized Gains (Losses)	Transferred From Other Levels	Balance as of December 31, 2016
Asset backed securities	$3	$—	$ —	$ (2)	$—	$1
Corporate bonds	1	—	—	—	—	1
Other	2	—	(28)	28	—	2
Total	$6	$—	$(28)	$26	$—	$4

Transfers of pension and postretirement plan assets in and out of Level 3 during 2015, by asset category were as follows (1):

	Balance as of January 1, 2015	Purchases, Sales, Issuances and Settlements (net)	Realized Gains (Losses)	Unrealized Gains (Losses)	Transferred From Other Levels	Balance as of December 31, 2015
Asset backed securities	$3	$—	$—	$—	$—	$3
Corporate bonds	2	(1)	—	—	—	1
Other	2	—	—	—	—	2
Total	$7	$ (1)	$—	$—	$—	$6

(1) See note 1 for additional information on the fair value hierarchy.

Defined Contribution Plans

RAI sponsors qualified defined contribution plans. The expense related to these plans was $41 million in 2016, $40 million in 2015 and $37 million in 2014. Included in the plans is a non-leveraged employee stock ownership plan, which holds shares of the Reynolds Stock Fund. Participants can elect to contribute to the fund. Dividends paid on shares are reflected as a reduction of equity. All shares are considered outstanding for earnings per share computations.

Note 17 — Segment Information

RAI's reportable operating segments are RJR Tobacco, Santa Fe and American Snuff. The RJR Tobacco segment consists of the primary operations of R. J. Reynolds Tobacco Company. The Santa Fe segment consists of the primary operations of SFNTC. The American Snuff segment consists of the primary operations of American Snuff Co. Included in All Other, among other RAI subsidiaries, are RJR Vapor, Niconovum USA, Inc., Niconovum AB, and until their sale on January 13, 2016, SFRTI and various foreign subsidiaries affiliated with SFRTI. The segments were identified based on how RAI's chief operating decision maker allocates resources and assesses performance. Certain of RAI's operating subsidiaries have entered into intercompany agreements for products or services with other subsidiaries. As a result, certain activities of an operating subsidiary may be included in a different segment of RAI.

RAI's largest reportable operating segment, RJR Tobacco, is the second largest tobacco company in the United States. Its brands include three of the top four best-selling cigarettes in the United States: NEWPORT, CAMEL and PALL MALL. These brands, and its other brands, including DORAL, MISTY and CAPRI, are manufactured in a variety of styles and marketed in the United States. As part of its total tobacco strategy, RJR Tobacco also offers a smoke-free tobacco product, CAMEL Snus. RJR Tobacco manages contract manufacturing of cigarette and tobacco products through arrangements with BAT affiliates, and manages the export of tobacco products to U.S. territories, U.S. duty-free shops and U.S. overseas military bases. RJR Tobacco also manages the super-premium cigarettes, DUNHILL and STATE EXPRESS 555, which are licensed from BAT. For additional information regarding related parties, see note 18.

Santa Fe manufactures and markets super-premium cigarettes and other tobacco products under the NATURAL AMERICAN SPIRIT brand in the United States.

American Snuff is the second largest smokeless tobacco products manufacturer in the United States. American Snuff's primary brands include its largest selling moist snuff brands, GRIZZLY and KODIAK.

RJR Vapor is a marketer of digital vapor cigarettes, manufactured on its behalf by RJR Tobacco, under the VUSE brand name in the United States. Niconovum USA, Inc. and Niconovum AB are marketers of nicotine replacement therapy products in the United States and Sweden, respectively, under the ZONNIC brand name.

SFRTI and various foreign subsidiaries affiliated with SFRTI distributed the NATURAL AMERICAN SPIRIT brand outside the United States. On January 13, 2016, RAI, through the Sellers, completed the sale of the international rights to the NATURAL AMERICAN SPIRIT brand name and associated trademarks, along with the international companies that distributed and marketed the brand outside the United States to JTI Holding, in an all-cash transaction of approximately $5 billion and recognized a pre-tax gain of approximately $4.9 billion. See note 3 for additional information.

Intersegment revenues and items below the operating income line of the consolidated statements of income are not presented by segment, since they are excluded from the measure of segment profitability reviewed by RAI's chief operating decision maker. Additionally, information about total assets by segment is not reviewed by RAI's chief operating decision maker and therefore is not disclosed.

Segment Data:

	2016	2015	2014
Net sales:			
RJR Tobacco	$10,314	$ 8,634	$6,767
Santa Fe	973	818	658
American Snuff	914	855	783
All Other	302	368	263
Consolidated net sales	$12,503	$10,675	$8,471
Operating income (loss):			
RJR Tobacco (1)(2)	$ 4,922	$ 3,359	$2,173
Santa Fe	546	449	337
American Snuff (2)	541	502	438
All Other (3)	(145)	(265)	(234)
Gain on divestitures	4,861	3,181	—
Corporate Expense (2)	(156)	(273)	(183)
Consolidated operating income	$10,569	$ 6,953	$2,531
Cash capital expenditures:			
RJR Tobacco	$ 130	$ 84	$ 53
Santa Fe	12	16	7
American Snuff	22	10	12
All Other	42	64	132
Consolidated capital expenditures	$ 206	$ 174	$ 204
Depreciation and amortization expense:			
RJR Tobacco	$ 77	$ 71	$ 65
Santa Fe	4	3	3
American Snuff	16	17	17
All Other	26	31	21
Consolidated depreciation and amortization expense	$ 123	$ 122	$ 106
Reconciliation to income from continuing operations before income taxes:			
Consolidated operating income (1)(2)(3)	$10,569	$ 6,953	$2,531
Interest and debt expense	626	570	286
Interest income	(8)	(6)	(3)
Other (income) expense, net	260	5	(14)
Income from continuing operations before income taxes	$ 9,691	$ 6,384	$2,262

(1) Includes NPM Adjustment credits of $388 million, $293 million and $341 million for RJR Tobacco for the years ended December 31, 2016, 2015 and 2014, respectively.

(2) Includes MTM adjustment expense of $42 million for RJR Tobacco and $3 million for Corporate Expense for the year ended December 31, 2016. Includes MTM adjustment expense of $229 million for RJR Tobacco, $1 million for American Snuff and $16 million for Corporate Expense and All Other for the year ended December 31, 2015. Includes MTM adjustment expense of $422 million for RJR Tobacco, $4 million for American Snuff and $26 million for Corporate Expense and All Other for the year ended December 31, 2014.

(3) Includes $99 million of asset impairment and exit charges for the year ended December 31, 2015. See note 6.

Sales to McLane Company, Inc., a distributor, constituted approximately 28% of RAI's consolidated revenue in each of 2016 and 2015 and 31% in 2014. Sales to Core-Mark International, Inc., a distributor, represented approximately 14%, 10% and 11% of RAI's consolidated revenue in 2016, 2015 and 2014, respectively. McLane Company, Inc. and Core-Mark International, Inc. are customers of RJR Tobacco, Santa Fe and American Snuff. No other customer accounted for 10% or more of RAI's consolidated revenue during those periods.

RAI's operating subsidiaries' sales to foreign countries, primarily to related parties, for the years ended December 31, 2016, 2015 and 2014 were $351 million, $482 million and $497 million, respectively.

Note 18 — Related Party Transactions

RAI and RAI's operating subsidiaries engage in transactions with affiliates of BAT. BAT, through wholly owned subsidiaries, beneficially owns approximately 42% of RAI's outstanding common stock. The following is a summary of balances and transactions with such BAT affiliates as of and for the years ended December 31:

	2016	2015
Current Balances:		
Accounts receivable, related party	$113	$38
Due to related party	7	9
Deferred revenue, related party	66	33
Other current liabilities	—	2
Long-term Balances:		
Long-term deferred revenue, related party	$ 39	$—

	2016	2015	2014
Significant Transactions:			
Net sales	$226	$ 259	$311
Purchases	21	38	28
BAT Share Purchase	—	4,673	—
Share repurchase agreements	32	—	155
Research and development services billings	1	3	4

RJR Tobacco sells contract-manufactured cigarettes, tobacco leaf and processed tobacco to BAT affiliates. In December 2012, RJR Tobacco entered into an amendment to its contract manufacturing agreement (relating to the production of cigarettes to be sold in Japan) with a BAT affiliate, which amendment, among other things, requires either party to provide three years' notice to the other party to terminate the agreement without cause, with any such notice to be given no earlier than January 1, 2016. On January 4, 2016, RJR Tobacco received written notice from a BAT affiliate terminating that contract manufacturing agreement effective January 5, 2019. In July 2016, RJR Tobacco further amended the contract manufacturing agreement with a BAT affiliate to permit an early transition of the cigarette production covered by the agreement to BAT facilities over several months beginning in the fourth quarter of 2016. The amendment provides for a BAT affiliate to make a payment to RJR Tobacco of $89.6 million, in exchange for RJR Tobacco's commitment to provide contingent manufacturing capacity to a BAT affiliate through December 31, 2018. Of this amount, $40.2 million was recorded as current deferred revenue and $38.9 million was recorded as long-term deferred revenue in RAI's consolidated balance sheet as of December 31, 2016. The first installment of $7.4 million was received in September 2016. The second installment of $82.2 million is due on or before March 31, 2017. RJR Tobacco will recognize the income ratably from the effective date of the amendment to December 31, 2018. Net sales to BAT affiliates, primarily cigarettes, represented approximately 2% of RAI's total net sales in each of 2016 and 2015, and 4% in 2014.

RJR Tobacco recorded deferred sales revenue relating to leaf sold to BAT affiliates that had not been delivered as of December 31, in each of 2016, 2015 and 2014, given that RJR Tobacco has a legal right to bill the BAT affiliates. Leaf sales revenue to BAT affiliates is recognized when the product is shipped to the customer.

RAI's operating subsidiaries also purchase unprocessed leaf at market prices, and import cigarettes at prices not to exceed manufacturing costs plus 10%, from BAT affiliates.

RJR Tobacco performs certain research and development for BAT affiliates pursuant to a joint technology sharing agreement entered into as a part of the B&W business combination. These services were billed to BAT affiliates and were recorded in RJR Tobacco's selling, general and administrative expenses, net of associated costs.

In January 2016, prior to the sale of the international rights to the NATURAL AMERICAN SPIRIT brand to JTI, SFRTI paid $6 million to a BAT affiliate pursuant to a contract manufacturing agreement, whereby the BAT affiliate agreed to contract manufacture certain tobacco products for SFRTI. The $6 million fee paid to amend the contract was recognized within selling, general and administrative expenses in the consolidated statements of income.

In connection with the Share Repurchase Program, B&W and LSL, wholly owned subsidiaries of BAT, entered into the Share Repurchase Agreement on July 25, 2016, with RAI, pursuant to which BAT and its subsidiaries will participate in the Share Repurchase Program on a basis approximately proportionate with BAT and its subsidiaries' ownership of RAI common stock. Under the Share Repurchase Agreement, RAI repurchased 660,385 shares of RAI common stock for $32 million from BAT and its subsidiaries during the year ended December 31, 2016. The Merger Agreement places restrictions on RAI's ability to repurchase its common stock. As a result, RAI does not expect to make repurchases under the Share Repurchase Program while the Merger Agreement is in effect.

On June 12, 2015, RAI and BAT completed the BAT Share Purchase in connection with the Lorillard Merger and Divestiture. For additional information, see note 2.

In December 2015, RJR Tobacco and Nicoventures Holdings Limited, a subsidiary of BAT, signed a definitive vapor technology-sharing and licensing agreement, pursuant to which the companies collaborate on the development of next generation vapor products.

For information regarding the BAT Merger, see note 22.

Note 19 — RAI Guaranteed, Unsecured Notes — Condensed Consolidating Financial Statements

The following condensed consolidating financial statements relate to the guaranties of RAI's $12.7 billion aggregate principal amount of unsecured notes. See note 12 for additional information relating to these notes. Certain of RAI's direct, wholly owned subsidiaries and certain of its indirectly owned subsidiaries have fully and unconditionally, and jointly and severally, guaranteed these notes. The following condensed consolidating financial statements include: the accounts and activities of RAI, the parent issuer; RJR, RJR Tobacco, SFNTC, American Snuff Co. and certain of RAI's other subsidiaries, the Guarantors; other direct and indirect subsidiaries of RAI that are not Guarantors; and elimination adjustments.

Condensed Consolidating Statements of Income
(Dollars in Millions)

	Parent Issuer	Guarantors	Non-Guarantors	Eliminations	Consolidated
For the Year Ended December 31, 2016					
Net sales	$ —	$12,209	$ 198	$ (130)	$12,277
Net sales, related party	—	226	—	—	226
Net sales	—	12,435	198	(130)	12,503
Cost of products sold	—	4,787	185	(131)	4,841
Selling, general and administrative expenses	41	1,721	167	2	1,931
Gain on divestitures	—	(4,843)	(16)	(2)	(4,861)
Amortization expense	—	22	1	—	23
Operating income (loss)	(41)	10,748	(139)	1	10,569
Interest and debt expense	619	81	9	(83)	626
Interest income	(84)	(6)	(1)	83	(8)
Other (income) expense, net	244	(30)	3	43	260
Income (loss) before income taxes	(820)	10,703	(150)	(42)	9,691
Provision for (benefit from) income taxes	(171)	3,840	(51)	—	3,618
Equity income from subsidiaries	6,722	4	—	(6,726)	—
Net income (loss)	$6,073	$ 6,867	$ (99)	$(6,768)	$ 6,073
For the Year Ended December 31, 2015					
Net sales	$ —	$10,319	$ 333	$ (236)	$10,416
Net sales, related party	—	259	—	—	259
Net sales	—	10,578	333	(236)	10,675
Cost of products sold	—	4,673	248	(233)	4,688
Selling, general and administrative expenses	79	1,738	281	—	2,098
Gain on divestitures	—	(3,153)	(28)	—	(3,181)
Amortization expense	—	18	—	—	18
Asset impairment and exit charges	—	99	—	—	99
Operating income (loss)	(79)	7,203	(168)	(3)	6,953
Interest and debt expense	559	104	7	(100)	570
Interest income	(100)	(6)	—	100	(6)
Other (income) expense, net	20	(42)	(16)	43	5
Income (loss) before income taxes	(558)	7,147	(159)	(46)	6,384
Provision for (benefit from) income taxes	(224)	3,417	(62)	—	3,131
Equity income from subsidiaries	3,587	46	—	(3,633)	—
Net income (loss)	$3,253	$ 3,776	$ (97)	$(3,679)	$ 3,253
For the Year Ended December 31, 2014					
Net sales	$ —	$ 8,109	$ 232	$ (181)	$ 8,160
Net sales, related party	—	311	—	—	311
Net sales	—	8,420	232	(181)	8,471
Cost of products sold	—	4,002	235	(179)	4,058
Selling, general and administrative expenses	75	1,535	261	—	1,871
Amortization expense	—	11	—	—	11
Operating income (loss)	(75)	2,872	(264)	(2)	2,531
Interest and debt expense	286	79	6	(85)	286
Interest income	(85)	(3)	—	85	(3)
Other (income) expense, net	4	(44)	(17)	43	(14)
Income (loss) from continuing operations before income taxes	(280)	2,840	(253)	(45)	2,262
Provision for (benefit from) income taxes	(89)	1,004	(98)	—	817
Equity income from subsidiaries	1,661	26	—	(1,687)	—
Income (loss) from continuing operations	1,470	1,862	(155)	(1,732)	1,445
Income from discontinued operations, net of tax	—	25	—	—	25
Net income (loss)	$1,470	$ 1,887	$(155)	$(1,732)	$ 1,470

Condensed Consolidating Statements of Comprehensive Income
(Dollars in Millions)

	Parent Issuer	Guarantors	Non-Guarantors	Eliminations	Consolidated
For the Year Ended December 31, 2016					
Net income (loss)	$6,073	$6,867	$ (99)	$(6,768)	$6,073
Other comprehensive income (loss), net of tax:					
Retirement benefits	(11)	(12)	(4)	16	(11)
Long-term investments	14	14	—	(14)	14
Hedging instruments	11	—	—	—	11
Cumulative translation adjustment and other	10	10	13	(23)	10
Comprehensive income (loss)	$6,097	$6,879	$ (90)	$(6,789)	$6,097
For the Year Ended December 31, 2015					
Net income (loss)	$3,253	$3,776	$ (97)	$(3,679)	$3,253
Other comprehensive income (loss), net of tax:					
Retirement benefits	50	50	13	(63)	50
Hedging instruments	1	—	—	—	1
Cumulative translation adjustment and other	(25)	(27)	(37)	64	(25)
Comprehensive income (loss)	$3,279	$3,799	$(121)	$(3,678)	$3,279
For the Year Ended December 31, 2014					
Net income (loss)	$1,470	$1,887	$(155)	$(1,732)	$1,470
Other comprehensive income (loss), net of tax:					
Retirement benefits	(277)	(271)	(1)	272	(277)
Long-term investments	2	2	—	(2)	2
Hedging instruments	1	—	—	—	1
Cumulative translation adjustment and other	(34)	(34)	(48)	82	(34)
Comprehensive income (loss)	$1,162	$1,584	$(204)	$(1,380)	$1,162

Details about the reclassifications out of accumulated other comprehensive loss and the affected line items in the consolidating statement of income for the year ended December 31, 2016, were as follows:

Components	Amount Reclassified					Affected Line Item
	Parent Issuer	Guarantors	Non-Guarantors	Eliminations	Consolidated	
Retirement benefits:						
Amortization of prior service cost	$—	$(20)	$—	$ —	$(20)	Cost of products sold
Amortization of prior service cost	—	(19)	—	—	(19)	Selling, general and administrative expenses
Settlement cost	—	2	—	—	2	Selling, general and administrative expenses
MTM adjustment	—	21	—	—	21	Cost of products sold
MTM adjustment	4	26	(6)	—	24	Selling, general and administrative expenses
	4	10	(6)	—	8	Operating income (loss)
Deferred taxes	—	(1)	—	—	(1)	Provision for (benefit from) income taxes
Net of tax	4	9	(6)	—	7	Net income (loss)
Long-term investments:						
Realized loss, net on long-term investments	—	24	—	—	24	Other (income) expense, net
Deferred taxes	—	(10)	—	—	(10)	Provision for (benefit from) income taxes
Net of tax	—	14	—	—	14	Net income (loss)
Hedging instruments:						
Forward starting interest rate contracts	16	—	—	—	16	Other (income) expense, net
Amortization of realized loss	1	—	—	—	1	Interest and debt expense
Deferred taxes	(6)	—	—	—	(6)	Provision for (benefit from) income taxes
Net of tax	11	—	—	—	11	Net income (loss)
Cumulative translation adjustment and other:						
Derecognition of cumulative translation adjustment	—	—	27	—	27	Gain on divestitures
Equity income from subsidiaries	44	21	—	(65)	—	Equity income from subsidiaries
Total reclassifications	$59	$ 44	$21	$(65)	$ 59	Net income (loss)

Details about the reclassifications out of accumulated other comprehensive loss and the affected line items in the consolidating statement of income for the year ended December 31, 2015, were as follows:

Components	Amount Reclassified					Affected Line Item
	Parent Issuer	Guarantors	Non-Guarantors	Eliminations	Consolidated	
Retirement benefits:						
Amortization of prior service cost	$ —	$ (20)	$—	$ —	$ (20)	Cost of products sold
Amortization of prior service cost	—	(19)	—	—	(19)	Selling, general and administrative expenses
MTM adjustment	—	120	—	—	120	Cost of products sold
MTM adjustment	5	121	—	—	126	Selling, general and administrative expenses
	5	202	—	—	207	Operating income (loss)
Deferred taxes	(1)	(78)	—	—	(79)	Provision for (benefit from) income taxes
Net of tax	4	124	—	—	128	Net income (loss)
Hedging instruments:						
Amortization of realized loss	2	—	—	—	2	Interest and debt expense
Deferred taxes	(1)	—	—	—	(1)	Provision for (benefit from) income taxes
Net of tax	1	—	—	—	1	Net income (loss)
Equity income from subsidiaries	124	—	—	(124)	—	Equity income from subsidiaries
Total reclassifications	$129	$124	$—	$(124)	$129	Net income (loss)

Details about the reclassifications out of accumulated other comprehensive loss and the affected line items in the consolidating statement of income for the year ended December 31, 2014, were as follows:

Components	Amount Reclassified					Affected Line Item
	Parent Issuer	Guarantors	Non-Guarantors	Eliminations	Consolidated	
Retirement benefits:						
Amortization of prior service cost	$ —	$ (21)	$—	$ —	$ (21)	Cost of products sold
Amortization of prior service cost	—	(18)	—	—	(18)	Selling, general and administrative expenses
MTM adjustment	—	205	—	—	205	Cost of products sold
MTM adjustment	10	236	1	—	247	Selling, general and administrative expenses
	10	402	1	—	413	Operating income (loss)
Deferred taxes	(4)	(158)	—	—	(162)	Provision for (benefit from) income taxes
Net of tax	6	244	1	—	251	Net income (loss)
Hedging instruments:						
Amortization of realized loss	2	—	—	—	2	Interest and debt expense
Deferred taxes	(1)	—	—	—	(1)	Provision for (benefit from) income taxes
Net of tax	1	—	—	—	1	Net income (loss)
Equity income from subsidiaries	245	—	—	(245)	—	Equity income from subsidiaries
Total reclassifications	$252	$ 244	$ 1	$(245)	$ 252	Net income (loss)

Condensed Consolidating Statements of Cash Flows
(Dollars in Millions)

	Parent Issuer	Guarantors	Non-Guarantors	Eliminations	Consolidated
For the Year Ended December 31, 2016					
Cash flows from (used in) operating activities	$ (413)	$ 3,162	$(234)	$(1,235)	$ 1,280
Cash flows from (used in) investing activities:					
Capital expenditures	—	(211)	(7)	12	(206)
Proceeds from settlement of investments	—	266	—	—	266
Proceeds from divestitures	5,015	—	—	—	5,015
Return of intercompany investments	2,274	26	—	(2,300)	—
Contributions to intercompany investments	(16)	—	—	16	—
Other, net	193	24	—	(214)	3
Net cash flows from (used in) investing activities	7,466	105	(7)	(2,486)	5,078
Cash flows from (used in) financing activities:					
Dividends paid on common stock	(2,369)	(1,152)	(28)	1,180	(2,369)
Repurchase of common stock	(226)	—	—	—	(226)
Repayments of long-term debt	(415)	(85)	—	—	(500)
Early extinguishment of debt	(3,642)	(8)	—	—	(3,650)
Premiums paid for early extinguishment of debt	(206)	(1)	—	—	(207)
Proceeds from termination of interest rate swaps	—	66	—	—	66
Debt issuance costs and financing fees	(8)	—	—	—	(8)
Excess tax benefit on stock-based compensation plans	28	—	—	—	28
Dividends paid on preferred stock	(43)	—	—	43	—
Distribution of equity	—	(2,274)	(26)	2,300	—
Receipt of equity	—	—	16	(16)	—
Other, net	(21)	(360)	167	214	—
Net cash flows from (used in) financing activities	(6,902)	(3,814)	129	3,721	(6,866)
Effect of exchange rate changes on cash and cash equivalents	—	—	(8)	—	(8)
Net change in cash and cash equivalents	151	(547)	(120)	—	(516)
Cash and cash equivalents at beginning of year	575	1,544	448	—	2,567
Cash and cash equivalents at end of year	$ 726	$ 997	$ 328	$ —	$ 2,051

Condensed Consolidating Statements of Cash Flows
(Dollars in Millions)

	Parent Issuer	Guarantors	Non-Guarantors	Eliminations	Consolidated
For the Year Ended December 31, 2015					
Cash flows from (used in) operating activities	$ (2,279)	$ 3,219	$ 6	$(750)	$ 196
Cash flows from (used in) investing activities:					
Capital expenditures	—	(160)	(12)	(2)	(174)
Proceeds from settlement of investments	—	332	—	—	332
Acquisition, net of cash acquired	(18,278)	1,001	57	—	(17,220)
Proceeds from divestitures	7,056	—	—	—	7,056
Return of intercompany investments	185	—	—	(185)	—
Other, net	10	22	—	(31)	1
Net cash flows from (used in) investing activities	(11,027)	1,195	45	(218)	(10,005)
Cash flows from (used in) financing activities:					
Dividends paid on common stock	(1,583)	(709)	—	709	(1,583)
Repurchase of common stock	(124)	—	—	—	(124)
Proceeds from BAT Share Purchase	4,673	—	—	—	4,673
Issuance of long-term debt	8,975	—	—	—	8,975
Repayments of long-term debt	(450)	—	—	—	(450)
Debt issuance costs and financing fees	(70)	—	—	—	(70)
Borrowings under revolving credit facility	1,400	—	—	—	1,400
Repayments of borrowings under revolving credit facility	(1,400)	—	—	—	(1,400)
Excess tax benefit on stock-based compensation plans	17	—	—	—	17
Dividends paid on preferred stock	(43)	—	—	43	—
Distribution of equity	—	(185)	—	185	—
Other, net	2,384	(2,445)	30	31	—
Net cash flows from (used in) financing activities	13,779	(3,339)	30	968	11,438
Effect of exchange rate changes on cash and cash equivalents	—	—	(28)	—	(28)
Net change in cash and cash equivalents	473	1,075	53	—	1,601
Cash and cash equivalents at beginning of year	102	469	395	—	966
Cash and cash equivalents at end of year	$ 575	$ 1,544	$448	$ —	$ 2,567

Condensed Consolidating Statements of Cash Flows
(Dollars in Millions)

	Parent Issuer	Guarantors	Non-Guarantors	Eliminations	Consolidated
For the Year Ended December 31, 2014					
Cash flows from (used in) operating activities	$ 1,277	$ 1,865	$(179)	$(1,340)	$ 1,623
Cash flows from (used in) investing activities:					
Capital expenditures	—	(265)	(94)	155	(204)
Proceeds from termination of joint venture	—	—	35	—	35
Proceeds from settlement of investments	—	4	—	—	4
Return of intercompany investments	165	—	—	(165)	—
Contributions to intercompany investments	(32)	—	—	32	—
Other, net	250	35	126	(451)	(40)
Net cash flows from (used in) investing activities	383	(226)	67	(429)	(205)
Cash flows from (used in) financing activities:					
Dividends paid on common stock	(1,411)	(1,301)	—	1,301	(1,411)
Repurchase of common stock	(440)	—	—	—	(440)
Borrowings under revolving credit facility	1,000	—	—	—	1,000
Repayments of borrowings under revolving credit facility	(1,000)	—	—	—	(1,000)
Debt issuance costs and financing fees	(79)	—	—	—	(79)
Excess tax benefit on stock-based compensation plans	12	—	—	—	12
Dividends paid on preferred stock	(43)	—	—	43	—
Distribution of equity	—	(165)	—	165	—
Receipt of equity	—	—	32	(32)	—
Other, net	(41)	(400)	149	292	—
Net cash flows from (used in) financing activities	(2,002)	(1,866)	181	1,769	(1,918)
Effect of exchange rate changes on cash and cash equivalents	—	—	(34)	—	(34)
Net change in cash and cash equivalents	(342)	(227)	35	—	(534)
Cash and cash equivalents at beginning of year	444	696	360	—	1,500
Cash and cash equivalents at end of year	$ 102	$ 469	$ 395	$ —	$ 966

Condensed Consolidating Balance Sheets
(Dollars in Millions)

	Parent Issuer	Guarantors	Non-Guarantors	Eliminations	Consolidated
December 31, 2016					
Assets					
Cash and cash equivalents	$ 726	$ 997	$328	$ —	$ 2,051
Accounts receivable	—	62	4	—	66
Accounts receivable, related party	—	113	—	—	113
Other receivables	63	3,572	17	(3,642)	10
Inventories	—	1,604	43	(2)	1,645
Other current assets	112	238	—	3	353
Total current assets	901	6,586	392	(3,641)	4,238
Property, plant and equipment, net	2	1,314	32	—	1,348
Trademarks and other intangible assets, net of accumulated amortization	—	29,432	14	(2)	29,444
Goodwill	—	15,976	16	—	15,992
Long-term intercompany notes receivable	1,390	148	—	(1,538)	—
Investment in subsidiaries	36,865	333	—	(37,198)	—
Other assets and deferred charges	80	52	37	(96)	73
Total assets	$39,238	$53,841	$491	$(42,475)	$51,095
Liabilities and shareholders' equity					
Accounts payable	$ 1	$ 213	$ 7	$ —	$ 221
Tobacco settlement accruals	—	2,498	—	—	2,498
Due to related party	—	7	—	—	7
Deferred revenue, related party	—	66	—	—	66
Current maturities of long-term debt	448	53	—	—	501
Dividends payable on common stock	656	—	—	—	656
Other current liabilities	3,767	871	40	(3,642)	1,036
Total current liabilities	4,872	3,708	47	(3,642)	4,985
Long-term intercompany notes payable	148	900	490	(1,538)	—
Long-term debt (less current maturities)	12,404	260	—	—	12,664
Long-term deferred income taxes, net	—	9,700	—	(93)	9,607
Long-term retirement benefits (less current portion)	59	1,767	43	—	1,869
Long-term deferred revenue, related party	—	39	—	—	39
Other noncurrent liabilities	44	176	—	—	220
Shareholders' equity	21,711	37,291	(89)	(37,202)	21,711
Total liabilities and shareholders' equity	$39,238	$53,841	$491	$(42,475)	$51,095

Condensed Consolidating Balance Sheets
(Dollars in Millions)

	Parent Issuer	Guarantors	Non-Guarantors	Eliminations	Consolidated
December 31, 2015					
Assets					
Cash and cash equivalents	$ 575	$ 1,544	$448	$ —	$ 2,567
Short-term investments	—	149	—	—	149
Accounts receivable	—	62	6	—	68
Accounts receivable, related party	—	38	—	—	38
Other receivables	70	3,459	91	(3,585)	35
Inventories	—	1,694	44	(4)	1,734
Other current assets	116	323	129	(4)	564
Total current assets	761	7,269	718	(3,593)	5,155
Property, plant and equipment, net	3	1,223	29	—	1,255
Trademarks and other intangible assets, net of accumulated amortization	—	29,467	—	—	29,467
Goodwill	—	15,976	17	—	15,993
Long-term intercompany notes receivable	1,583	169	—	(1,752)	—
Investment in subsidiaries	37,151	662	—	(37,813)	—
Other assets and deferred charges	189	212	38	(209)	230
Total assets	$39,687	$54,978	$802	$(43,367)	$52,100
Liabilities and shareholders' equity					
Accounts payable	$ 2	$ 173	$ 4	$ —	$ 179
Tobacco settlement accruals	—	2,816	—	—	2,816
Due to related party	—	9	—	—	9
Deferred revenue, related party	—	33	—	—	33
Current maturities of long-term debt	420	86	—	—	506
Dividends payable on common stock	514	—	—	—	514
Other current liabilities	3,707	1,039	79	(3,591)	1,234
Total current liabilities	4,643	4,156	83	(3,591)	5,291
Long-term intercompany notes payable	169	1,260	323	(1,752)	—
Long-term debt (less current maturities)	16,522	327	—	—	16,849
Long-term deferred income taxes, net	—	9,410	—	(206)	9,204
Long-term retirement benefits (less current portion)	57	2,153	55	—	2,265
Other noncurrent liabilities	44	195	—	—	239
Shareholders' equity	18,252	37,477	341	(37,818)	18,252
Total liabilities and shareholders' equity	$39,687	$54,978	$802	$(43,367)	$52,100

Note 20 — RJR Tobacco Guaranteed, Unsecured Notes — Condensed Consolidating Financial Statements

The following condensed consolidating financial statements relate to the guaranties of RJR Tobacco's $284 million aggregate principal amount of unsecured notes, representing the Lorillard Tobacco Notes assumed by RJR Tobacco in connection with the Lorillard Tobacco Merger. RAI and RJR have fully and unconditionally, and jointly and severally, guaranteed these notes. The following condensed consolidating financial statements include: the accounts and activities of RAI, the Parent Guarantor; RJR Tobacco, the Issuer; RJR, a Guarantor; other direct and indirect subsidiaries of RAI that are not Guarantors; and elimination adjustments.

Condensed Consolidating Statements of Income
(Dollars in Millions)

	Parent Guarantor	Issuer	Guarantor	Non-Guarantors	Eliminations	Consolidated
For the Year Ended December 31, 2016						
Net sales	$ —	$10,365	$ —	$ 2,229	$ (317)	$12,277
Net sales, related party	—	226	—	—	—	226
Net sales	—	10,591	—	2,229	(317)	12,503
Cost of products sold	—	4,323	—	837	(319)	4,841
Selling, general and administrative expenses, net	41	2,719	2	(834)	3	1,931
Gain on divestitures	—	—	—	(4,861)	—	(4,861)
Amortization expense	—	16	—	7	—	23
Operating income (loss)	(41)	3,533	(2)	7,080	(1)	10,569
Interest and debt expense	619	7	—	86	(86)	626
Interest income	(84)	(5)	(3)	(2)	86	(8)
Other (income) expense, net	244	12	(42)	3	43	260
Income (loss) before income taxes	(820)	3,519	43	6,993	(44)	9,691
Provision for (benefit from) income taxes	(171)	1,247	(1)	2,543	—	3,618
Equity income from subsidiaries	6,722	850	3,142	—	(10,714)	—
Net income	$6,073	$ 3,122	$3,186	$ 4,450	$(10,758)	$ 6,073
For the Year Ended December 31, 2015						
Net sales	$ —	$ 8,714	$ —	$ 2,039	$ (337)	$10,416
Net sales, related party	—	259	—	—	—	259
Net sales	—	8,973	—	2,039	(337)	10,675
Cost of products sold	—	4,277	—	746	(335)	4,688
Selling, general and administrative expenses, net	79	2,318	3	(302)	—	2,098
(Gain) loss on divestitures	—	1,887	—	(5,068)	—	(3,181)
Amortization expense	—	12	—	6	—	18
Asset impairment and exit charges	—	99	—	—	—	99
Operating income (loss)	(79)	380	(3)	6,657	(2)	6,953
Interest and debt expense	559	20	—	94	(103)	570
Interest income	(100)	(5)	(4)	—	103	(6)
Other (income) expense, net	20	2	(43)	(17)	43	5
Income (loss) before income taxes	(558)	363	44	6,580	(45)	6,384
Provision for (benefit from) income taxes	(224)	928	—	2,427	—	3,131
Equity income from subsidiaries	3,587	3,732	3,185	—	(10,504)	—
Net income	$3,253	$ 3,167	$3,229	$ 4,153	$(10,549)	$ 3,253
For the Year Ended December 31, 2014						
Net sales	$ —	$ 6,728	$ —	$ 1,701	$ (269)	$ 8,160
Net sales, related party	—	311	—	—	—	311
Net sales	—	7,039	—	1,701	(269)	8,471
Cost of products sold	—	3,641	—	686	(269)	4,058
Selling, general and administrative expenses	75	1,629	6	161	—	1,871
Amortization expense	—	4	—	7	—	11
Operating income (loss)	(75)	1,765	(6)	847	—	2,531
Interest and debt expense	286	21	—	67	(88)	286
Interest income	(85)	(2)	(3)	(1)	88	(3)
Other (income) expense, net	4	1	(45)	(17)	43	(14)
Income (loss) from continuing operations before income taxes	(280)	1,745	42	798	(43)	2,262
Provision for (benefit from) income taxes	(89)	627	(1)	280	—	817
Equity income from subsidiaries	1,661	279	1,425	—	(3,365)	—
Net income from continuing operations	1,470	1,397	1,468	518	(3,408)	1,445
Income from discontinued operations, net of tax	—	25	—	—	—	25
Net income	$1,470	$ 1,422	$1,468	$ 518	$ (3,408)	$ 1,470

Condensed Consolidating Statements of Comprehensive Income
(Dollars in Millions)

	Parent Guarantor	Issuer	Guarantor	Non-Guarantors	Eliminations	Consolidated
For the Year Ended December 31, 2016						
Net income	$6,073	$3,122	$3,186	$4,450	$(10,758)	$6,073
Other comprehensive income (loss), net of tax:						
Retirement benefits	(11)	(6)	(10)	(5)	21	(11)
Long-term investments	14	14	14	—	(28)	14
Hedging instruments	11	—	—	—	—	11
Cumulative translation adjustment and other	10	7	10	10	(27)	10
Comprehensive income	$6,097	$3,137	$3,200	$4,455	$(10,792)	$6,097
For the Year Ended December 31, 2015						
Net income	$3,253	$3,167	$3,229	$4,153	$(10,549)	$3,253
Other comprehensive income (loss), net of tax:						
Retirement benefits	50	39	51	12	(102)	50
Hedging instruments	1	—	—	—	—	1
Cumulative translation adjustment and other	(25)	(25)	(25)	(26)	76	(25)
Comprehensive income	$3,279	$3,181	$3,255	$4,139	$(10,575)	$3,279
For the Year Ended December 31, 2014						
Net income	$1,470	$1,422	$1,468	$ 518	$ (3,408)	$1,470
Other comprehensive income (loss), net of tax:						
Retirement benefits	(277)	(259)	(261)	(11)	531	(277)
Long-term investments	2	2	2	—	(4)	2
Hedging instruments	1	—	—	—	—	1
Cumulative translation adjustment and other	(34)	(32)	(32)	(33)	97	(34)
Comprehensive income	$1,162	$1,133	$1,177	$ 474	$ (2,784)	$1,162

Details about the reclassifications out of accumulated other comprehensive loss and the affected line items in the condensed consolidating statement of income for the year ended December 31, 2016, were as follows:

Components	Amounts Reclassified						Affected Line Item
	Parent Guarantor	Issuer	Guarantor	Non-Guarantors	Eliminations	Consolidated	
Retirement benefits:							
Amortization of prior service cost	$—	$(20)	$—	$—	$ —	$(20)	Cost of products sold
Amortization of prior service cost	—	(19)	—	—	—	(19)	Selling, general and administrative expenses, net
Settlement cost	—	2	—	—	—	2	Selling, general and administrative expenses, net
MTM adjustment	—	21	—	—	—	21	Cost of products sold
MTM adjustment	4	21	2	(3)	—	24	Selling, general and administrative expenses, net
	4	5	2	(3)	—	8	Operating income (loss)
Deferred taxes	—	(1)	—	—	—	(1)	Provision for (benefit from) income taxes
Net of tax	4	4	2	(3)	—	7	Net income
Long-term investments:							
Realized loss, net on long-term investments	—	24	—	—	—	24	Other (income) expense, net
Deferred taxes	—	(10)	—	—	—	(10)	Provision for (benefit from) income taxes
Net of tax	—	14	—	—	—	14	Net income
Hedging instruments:							
Forward starting interest rate contracts	16	—	—	—	—	16	Other (income) expense, net
Amortization of realized loss	1	—	—	—	—	1	Interest and debt expense
Deferred taxes	(6)	—	—	—	—	(6)	Provision for (benefit from) income taxes
Net of tax	11	—	—	—	—	11	Net income
Cumulative translation adjustment and other:							
Derecognition of cumulative translation adjustment	—	—	—	27	—	27	Gain on divestitures
Equity income from subsidiaries	44	27	39	—	(110)	—	Equity income from subsidiaries
Total reclassifications	$59	$ 45	$41	$24	$(110)	$ 59	Net income

Details about the reclassifications out of accumulated other comprehensive loss and the affected line items in the condensed consolidating statement of income for the year ended December 31, 2015, were as follows:

Components	Amounts Reclassified						Affected Line Item
	Parent Guarantor	Issuer	Guarantor	Non-Guarantors	Eliminations	Consolidated	
Retirement benefits:							
Amortization of prior service cost	$ —	$ (19)	$ —	$ (1)	$ —	$ (20)	Cost of products sold
Amortization of prior service cost	—	(17)	(1)	(1)	—	(19)	Selling, general and administrative expenses, net
MTM adjustment	—	119	—	1	—	120	Cost of products sold
MTM adjustment	5	110	3	8	—	126	Selling, general and administrative expenses, net
	5	193	2	7	—	207	Operating income (loss)
Deferred taxes	(1)	(74)	(1)	(3)	—	(79)	Provision for (benefit from) income taxes
Net of tax	4	119	1	4	—	128	Net income
Hedging instruments:							
Amortization of realized loss	2	—	—	—	—	2	Interest and debt expense
Deferred taxes	(1)	—	—	—	—	(1)	Provision for (benefit from) income taxes
Net of tax	1	—	—	—	—	1	Net income
Equity income from subsidiaries	124	—	118	—	(242)	—	Equity income from subsidiaries
Total reclassifications	$129	$119	$119	$ 4	$(242)	$129	Net income

Details about the reclassifications out of accumulated other comprehensive loss and the affected line items in the condensed consolidating statement of income for the year ended December 31, 2014, were as follows:

Components	Amounts Reclassified						Affected Line Item
	Parent Guarantor	Issuer	Guarantor	Non-Guarantors	Eliminations	Consolidated	
Retirement benefits:							
Amortization of prior service cost	$ —	$ (20)	$ —	$ (1)	$ —	$ (21)	Cost of products sold
Amortization of prior service cost	—	(17)	—	(1)	—	(18)	Selling, general and administrative expenses
MTM adjustment	—	195	—	10	—	205	Cost of products sold
MTM adjustment	10	228	4	5	—	247	Selling, general and administrative expenses
	10	386	4	13	—	413	Other (income) expense, net
Deferred taxes	(4)	(152)	(1)	(5)	—	(162)	Provision for (benefit from) income taxes
Net of tax	6	234	3	8	—	251	Net income
Hedging instruments:							
Amortization of realized loss	2	—	—	—	—	2	Interest and debt expense
Deferred taxes	(1)	—	—	—	—	(1)	Provision for (benefit from) income taxes
Net of tax	1	—	—	—	—	1	Net income
Equity income from subsidiaries	245	—	234	—	(479)	—	Equity income from subsidiaries
Total reclassifications	$252	$ 234	$237	$ 8	$(479)	$ 252	Net income

Condensed Consolidating Statements of Cash Flows
(Dollars in Millions)

	Parent Guarantor	Issuer	Guarantor	Non-Guarantors	Eliminations	Consolidated
For the Year Ended December 31, 2016						
Cash flows from (used in) operating activities	$ (413)	$ 2,462	$ 1,918	$ 827	$(3,514)	$ 1,280
Cash flows from (used in) investing activities:						
Capital expenditures	—	(143)	—	(75)	12	(206)
Proceeds from settlement of investments	—	266	—	—	—	266
Proceeds from divestitures	5,015	—	—	—	—	5,015
Return of intercompany investments	2,274	508	1,473	—	(4,255)	—
Contributions to intercompany investments	(16)	—	—	—	16	—
Other, net	193	3	17	21	(231)	3
Net cash flows from (used in) from investing activities	7,466	634	1,490	(54)	(4,458)	5,078
Cash flows from (used in) financing activities:						
Dividends paid on common stock	(2,369)	(1,752)	(1,152)	(555)	3,459	(2,369)
Repurchase of common stock	(226)	—	—	—	—	(226)
Repayments of long-term debt	(415)	(85)	—	—	—	(500)
Early extinguishment of debt	(3,642)	(8)	—	—	—	(3,650)
Premiums paid for early extinguishment of debt	(206)	(1)	—	—	—	(207)
Proceeds from termination of interest rate swaps	—	66	—	—	—	66
Debt issuance costs and financing fees	(8)	—	—	—	—	(8)
Excess tax benefit on stock-based compensation plans	28	—	—	—	—	28
Dividends paid on preferred stock	(43)	—	—	—	43	—
Distribution of equity	—	(1,455)	(2,274)	(526)	4,255	—
Receipt of equity	—	—	—	16	(16)	—
Other, net	(21)	—	—	(210)	231	—
Net cash flows used in financing activities	(6,902)	(3,235)	(3,426)	(1,275)	7,972	(6,866)
Effect of exchange rate changes on cash and cash equivalents	—	—	—	(8)	—	(8)
Net change in cash and cash equivalents	151	(139)	(18)	(510)	—	(516)
Cash and cash equivalents at beginning of period	575	809	19	1,164	—	2,567
Cash and cash equivalents at end of period	$ 726	$ 670	$ 1	$ 654	$ —	$ 2,051

Condensed Consolidating Statements of Cash Flows (Dollars in Millions)

	Parent Guarantor	Issuer	Guarantor	Non-Guarantors	Eliminations	Consolidated
For the Year Ended December 31, 2015						
Cash flows from (used in) operating activities	$ (2,279)	$ 2,924	$ 549	$ 422	$(1,420)	$ 196
Cash flows from (used in) investing activities:						
Capital expenditures	—	(99)	—	(73)	(2)	(174)
Proceeds from settlement of investments	—	332	—	—	—	332
Acquisition, net of cash acquired	(18,278)	523	—	535	—	(17,220)
Proceeds from divestitures	7,056	—	—	—	—	7,056
Return of intercompany investments	185	11	344	—	(540)	—
Other, net	10	1	17	21	(48)	1
Net cash flows from (used in) investing activities	(11,027)	768	361	483	(590)	(10,005)
Cash flows from (used in) financing activities:						
Dividends paid on common stock	(1,583)	(461)	(709)	(209)	1,379	(1,583)
Repurchase of common stock	(124)	—	—	—	—	(124)
Proceeds from BAT Share Purchase	4,673	—	—	—	—	4,673
Issuance of long-term debt	8,975	—	—	—	—	8,975
Repayments of long-term debt	(450)	—	—	—	—	(450)
Debt issuance costs and financing fees	(70)	—	—	—	—	(70)
Borrowings under revolving credit facility	1,400	—	—	—	—	1,400
Repayments of borrowings under revolving credit facility	(1,400)	—	—	—	—	(1,400)
Excess tax benefit on stock-based compensation plans	17	—	—	—	—	17
Dividends paid on preferred stock	(43)	—	—	—	43	—
Distribution of equity	—	(344)	(185)	(11)	540	—
Other, net	2,384	(2,405)	—	(27)	48	—
Net cash flows from (used in) financing activities	13,779	(3,210)	(894)	(247)	2,010	11,438
Effect of exchange rate changes on cash and cash equivalents	—	—	—	(28)	—	(28)
Net change in cash and cash equivalents	473	482	16	630	—	1,601
Cash and cash equivalents at beginning of period	102	327	3	534	—	966
Cash and cash equivalents at end of period	$ 575	$ 809	$ 19	$1,164	$ —	$ 2,567
For the Year Ended December 31, 2014						
Cash flows from operating activities	$ 1,277	$ 1,364	$ 1,424	$ 524	$(2,966)	$ 1,623
Cash flows from (used in) investing activities:						
Capital expenditures	—	(232)	—	(127)	155	(204)
Proceeds from settlement of investments	—	2	2	—	—	4
Proceeds from termination of joint venture	—	—	—	35	—	35
Return of intercompany investments	165	105	21	—	(291)	—
Contribution to intercompany investments	(32)	—	—	—	32	—
Other, net	250	(8)	19	187	(488)	(40)
Net cash flows from (used in) investing activities	383	(133)	42	95	(592)	(205)
Cash flows from (used in) financing activities:						
Dividends paid on common stock	(1,411)	(1,377)	(1,301)	(250)	2,928	(1,411)
Repurchase of common stock	(440)	—	—	—	—	(440)
Borrowings under revolving credit facility	1,000	—	—	—	—	1,000
Repayments of borrowings under revolving credit facility	(1,000)	—	—	—	—	(1,000)
Debt issuance costs and financing fees	(79)	—	—	—	—	(79)
Excess tax benefit on stock-based compensation plans	12	—	—	—	—	12
Dividends paid on preferred stock	(43)	—	—	—	43	—
Distribution of equity	—	(21)	(165)	(105)	291	—
Receipt of equity	—	—	—	32	(32)	—
Other, net	(41)	(20)	—	(267)	328	—
Net cash flows used in financing activities	(2,002)	(1,418)	(1,466)	(590)	3,558	(1,918)
Effect of exchange rate changes on cash and cash equivalents	—	—	—	(34)	—	(34)
Net change in cash and cash equivalents	(342)	(187)	—	(5)	—	(534)
Cash and cash equivalents at beginning of period	444	514	3	539	—	1,500
Cash and cash equivalents at end of period	$ 102	$ 327	$ 3	$ 534	$ —	$ 966

Condensed Consolidating Balance Sheets
(Dollars in Millions)

	Parent Guarantor	Issuer	Guarantor	Non-Guarantors	Eliminations	Consolidated
December 31, 2016						
Assets						
Cash and cash equivalents	$ 726	$ 670	$ 1	$ 654	$ —	$ 2,051
Accounts receivable	—	27	—	39	—	66
Accounts receivable, related party	—	113	—	—	—	113
Other receivables	63	5	38	4,828	(4,924)	10
Inventories	—	812	—	835	(2)	1,645
Other current assets	112	195	—	43	3	353
Total current assets	901	1,822	39	6,399	(4,923)	4,238
Property, plant and equipment, net	2	855	—	491	—	1,348
Trademarks and other intangible assets, net of accumulated amortization	—	317	—	29,129	(2)	29,444
Goodwill	—	3,453	9,853	2,686	—	15,992
Long-term intercompany notes receivable	1,390	—	73	148	(1,611)	—
Investment in subsidiaries	36,865	22,954	23,938	—	(83,757)	—
Other assets and deferred charges	80	1,204	11	13	(1,235)	73
Total assets	$39,238	$30,605	$33,914	$38,866	$(91,528)	$51,095
Liabilities and shareholders' equity						
Accounts payable	$ 1	$ 190	$ —	$ 30	$ —	$ 221
Tobacco settlement accruals	—	2,326	—	172	—	2,498
Due to related party	—	7	—	—	—	7
Deferred revenue, related party	—	66	—	—	—	66
Current maturities of long-term debt	448	53	—	—	—	501
Dividends payable on common stock	656	—	—	—	—	656
Other current liabilities	3,767	1,923	2	268	(4,924)	1,036
Total current liabilities	4,872	4,565	2	470	(4,924)	4,985
Long-term intercompany notes payable	148	—	—	1,463	(1,611)	—
Long-term debt (less current maturities)	12,404	260	—	—	—	12,664
Long-term deferred income taxes, net	—	—	—	10,839	(1,232)	9,607
Long-term retirement benefits (less current portion)	59	1,651	28	131	—	1,869
Long-term deferred revenue, related party	—	39	—	—	—	39
Other noncurrent liabilities	44	153	—	23	—	220
Shareholders' equity	21,711	23,937	33,884	25,940	(83,761)	21,711
Total liabilities and shareholders' equity	$39,238	$30,605	$33,914	$38,866	$(91,528)	$51,095

Condensed Consolidating Balance Sheets
(Dollars in Millions)

	Parent Guarantor	Issuer	Guarantor	Non-Guarantors	Eliminations	Consolidated
December 31, 2015						
Assets						
Cash and cash equivalents	$ 575	$ 809	$ 19	$ 1,164	$ —	$ 2,567
Short-term investments	—	149	—	—	—	149
Accounts receivable	—	48	—	20	—	68
Accounts receivable, related party	—	38	—	—	—	38
Other receivables	70	30	17	4,890	(4,972)	35
Inventories	—	941	—	797	(4)	1,734
Other current assets	116	236	—	212	—	564
Total current assets	761	2,251	36	7,083	(4,976)	5,155
Property, plant and equipment, net	3	792	—	460	—	1,255
Trademarks and other intangible assets, net of accumulated amortization	—	346	—	29,121	—	29,467
Goodwill	—	3,453	9,853	2,687	—	15,993
Long-term intercompany notes receivable	1,583	—	90	169	(1,842)	—
Investment in subsidiaries	37,151	23,199	24,276	—	(84,626)	—
Other assets and deferred charges	189	1,711	14	9	(1,693)	230
Total assets	$39,687	$31,752	$34,269	$39,529	$(93,137)	$52,100
Liabilities and shareholders' equity						
Accounts payable	$ 2	$ 146	$ —	$ 31	$ —	$ 179
Tobacco settlement accruals	—	2,673	—	143	—	2,816
Due to related party	—	9	—	—	—	9
Deferred revenue, related party	—	33	—	—	—	33
Current maturities of long-term debt	420	86	—	—	—	506
Dividends payable on common stock	514	—	—	—	—	514
Other current liabilities	3,707	2,189	31	284	(4,977)	1,234
Total current liabilities	4,643	5,136	31	458	(4,977)	5,291
Long-term intercompany notes payable	169	—	—	1,673	(1,842)	—
Long-term debt (less current maturities)	16,522	327	—	—	—	16,849
Long-term deferred income taxes, net	—	1	—	10,892	(1,689)	9,204
Long-term retirement benefits (less current portion)	57	2,036	30	142	—	2,265
Other noncurrent liabilities	44	182	—	13	—	239
Shareholders' equity	18,252	24,070	34,208	26,351	(84,629)	18,252
Total liabilities and shareholders' equity	$39,687	$31,752	$34,269	$39,529	$(93,137)	$52,100

Note 21 — Quarterly Results of Operations (Unaudited)

	First	Second	Third	Fourth
2016				
Net sales	$2,917	$3,195	$3,205	$3,186
Gross profit (1)	1,752	1,920	2,016	1,974
Net income (1)(2)	3,565	796	861	851
Per share data (3) :				
Basic:				
Net income	2.50	0.56	0.60	0.60
Diluted:				
Net income	2.49	0.56	0.60	0.60
2015				
Net sales	$2,057	$2,403	$3,161	$3,054
Gross profit (4)	1,207	1,319	1,757	1,704
Net income (4)(5)	389	1,928	657	279
Per share data (3) :				
Basic:				
Net income	0.36	1.70	0.46	0.20
Diluted:				
Net income	0.36	1.69	0.46	0.19

(1) Includes NPM Adjustment credits of $91 million in the first quarter of 2016, $98 million in the second quarter of 2016, $104 million in the third quarter of 2016 and $97 million in the fourth quarter of 2016, see "— Cost of Products Sold" in note 1. The fourth quarter of 2016 includes an MTM adjustment of $21 million.

(2) First quarter of 2016 reflects the impact of the sale of the international rights to the NATURAL AMERICAN SPIRIT brand. Fourth quarter of 2016 includes an additional MTM adjustment expense of $24 million for a total of $45 million.

(3) Income per share is computed independently for each of the periods presented. The sum of the income per share amounts for the quarters may not equal the total for the year.

(4) Includes NPM Adjustment credits of $66 million in the first quarter of 2015, $69 million in the second quarter of 2015, $76 million in the third quarter of 2015 and $86 million in the fourth quarter of 2015, see "— Cost of Products Sold" in note 1. The fourth quarter of 2015 includes an MTM adjustment expense of $120 million.

(5) Second quarter of 2015 reflects the impact of the Lorillard Merger and Divestiture. Fourth quarter of 2015 includes an additional MTM adjustment expense of $126 million for a total of $246 million.

Note 22 — Subsequent Event

Proposed Merger with BAT

On January 16, 2017, RAI, BAT, a subsidiary of BAT, and Merger Sub entered into the Merger Agreement pursuant to which, subject to the satisfaction or waiver of certain conditions, Merger Sub will merge with and into RAI, referred to as the BAT Merger, with RAI surviving as a wholly owned subsidiary of BAT.

The BAT Merger has been approved by the independent directors of RAI who formed a transaction committee to negotiate with BAT, given BAT's existing ownership stake in RAI and representation on RAI's Board, and by the Boards of Directors of both companies.

At the effective time of the BAT Merger, each share of RAI common stock (other than any shares of RAI common stock owned by BAT or any of its subsidiaries and by shareholders of RAI who have properly asserted and not lost or effectively withdrawn appraisal rights) will be converted into the right to receive 0.5260 of a BAT American Depositary Share and $29.44 in cash, without interest, and subject to adjustment to prevent dilution.

The BAT Merger is subject to customary closing conditions, including RAI and BAT shareholder approvals, including the approval of the BAT Merger by a majority of the shares of RAI common stock not owned, directly or indirectly, by BAT or its subsidiaries or any of RAI's subsidiaries, and regulatory approvals. The Merger Agreement contains certain other termination rights for each of RAI and BAT, including the right of each party to terminate the Merger Agreement if the BAT Merger has not been completed on or before December 31, 2017, subject to an extension of five business days if, on December 31, 2017, BAT has not completed all or any portion of the financing it needs to fund the BAT Merger and the transactions contemplated by the Merger Agreement.

Financing, however, is not a condition to the closing of the BAT Merger. Under certain circumstances, if the Merger Agreement is terminated, the terminating party must pay the non-terminating party a termination fee of $1 billion. In the event that the Merger Agreement is terminated due to an inability to obtain unconditional approval under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended, or any other antitrust laws, RAI will be entitled to receive a termination fee of $500 million from BAT. The BAT Merger is currently expected to close in the third quarter of 2017.

Each of RAI and BAT has made representations and warranties in the Merger Agreement. RAI and BAT each also have agreed to various covenants and agreements, including, among other things, to conduct their respective businesses in the ordinary course in all material respects during the period between the execution of the Merger Agreement and completion of the BAT Merger and not to engage in certain transactions during this period.

Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders
Reynolds American Inc.:

We have audited the accompanying consolidated balance sheets of Reynolds American Inc. and subsidiaries as of December 31, 2015 and 2014, and the related consolidated statements of income, comprehensive income, shareholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2015. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Reynolds American Inc. and subsidiaries as of December 31, 2015 and 2014, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2015, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Reynolds American Inc.'s internal control over financial reporting as of December 31, 2015, based on criteria established in *Internal Control — Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated February 11, 2016 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

/s/ KPMG LLP

Greensboro, North Carolina
February 11, 2016

Management's Report on Internal Control over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Rule 13a-15(f) of the Securities Exchange Act of 1934. Internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with generally accepted accounting principles and includes those policies and procedures that:

(i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of RAI,

(ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of RAI are being made only in accordance with authorizations of management and directors of RAI, and

(iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of RAI's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements and even when determined to be effective, can only provide reasonable assurance with respect to financial statement preparation and presentation. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies and procedures may deteriorate.

Management conducted an evaluation of the effectiveness of RAI's internal control over financial reporting based on the framework in *Internal Control — Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this evaluation, management concluded that RAI's system of internal control over financial reporting was effective as of December 31, 2015.

KPMG LLP, independent registered public accounting firm, has audited RAI's consolidated financial statements and issued an attestation report on RAI's internal control over financial reporting as of December 31, 2015.

Dated: February 11, 2016

Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders
Reynolds American Inc.:

We have audited Reynolds American Inc.'s internal control over financial reporting as of December 31, 2015, based on criteria established in *Internal Control — Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Reynolds American Inc.'s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Reynolds American Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2015, based on criteria established in *Internal Control — Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Reynolds American Inc. and subsidiaries as of December 31, 2015 and 2014, and the related consolidated statements of income, comprehensive income, shareholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2015, and our report dated February 11, 2016 expressed an unqualified opinion on those consolidated financial statements.

/s/ KPMG LLP

Greensboro, North Carolina
February 11, 2016

REYNOLDS AMERICAN INC.

CONSOLIDATED STATEMENTS OF INCOME
(Dollars in Millions, Except Per Share Amounts)

	For the Years Ended December 31,		
	2015	2014	2013
Net sales (1)	$10,416	$8,160	$7,899
Net sales, related party	259	311	337
Net sales	10,675	8,471	8,236
Costs and expenses:			
Cost of products sold (1)	4,688	4,058	3,678
Selling, general and administrative expenses	2,098	1,871	1,389
Gain on Divestiture	(3,181)	—	—
Amortization expense	18	11	5
Asset impairment and exit charges	99	—	—
Trademark and other intangible asset impairment charges	—	—	32
Operating income	6,953	2,531	3,132
Interest and debt expense	570	286	259
Interest income	(6)	(3)	(5)
Other (income) expense, net	5	(14)	137
Income from continuing operations before income taxes	6,384	2,262	2,741
Provision for income taxes	3,131	817	1,023
Income from continuing operations	3,253	1,445	1,718
Income from discontinued operations, net of tax	—	25	—
Net income	$ 3,253	$1,470	$1,718
Basic income per share:			
Income from continuing operations	$ 2.57	$ 1.36	$ 1.58
Income from discontinued operations	—	0.02	—
Net income	$ 2.57	$ 1.38	$ 1.58
Diluted income per share:			
Income from continuing operations	$ 2.57	$ 1.35	$ 1.57
Income from discontinued operations	—	0.02	—
Net income	$ 2.57	$ 1.37	$ 1.57
Dividends declared per share	$ 1.39	$ 1.34	$ 1.24

(1) Excludes excise taxes of $4,209 million, $3,625 million and $3,730 million for the years ended December 31, 2015, 2014 and 2013, respectively.

See Notes to Consolidated Financial Statements

REYNOLDS AMERICAN INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Dollars in Millions)

	For the Years Ended December 31,		
	2015	**2014**	**2013**
Net income	$3,253	$1,470	$1,718
Other comprehensive income (loss), net of tax:			
Retirement benefits, net of tax expense (benefit) (2015 — $32; 2014 — $(178); 2013 — $160)	50	(277)	248
Unrealized gain on long-term investments, net of tax expense (2014 — $1; 2013 — $3)	—	2	5
Amortization of realized loss on hedging instruments, net of tax expense (2015 — $1; 2014 — $1; 2013 — $1)	1	1	1
Cumulative translation adjustment and other, net of tax (benefit) expense (2015 — $(12); 2014 — $(15); 2013 — $12)	(25)	(34)	1
Comprehensive income	$3,279	$1,162	$1,973

See Notes to Consolidated Financial Statements

REYNOLDS AMERICAN INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS
(Dollars in Millions)

	For the Years Ended December 31,		
	2015	2014	2013
Cash flows from (used in) operating activities:			
Net income	$ 3,253	$ 1,470	$ 1,718
Income from discontinued operations, net of tax	—	(25)	—
Adjustments to reconcile to net cash flows from (used in) operating activities:			
Gain on Divestiture	(3,181)	—	—
Asset impairment and exit charges, net of cash payments	94		
Depreciation and amortization	122	106	103
Trademark and other intangible asset impairment charges	—	—	32
Loss on early extinguishment of debt	—	—	124
Deferred income tax expense (benefit)	(659)	(180)	312
Other changes that provided (used) cash:			
Accounts and other receivables	86	(3)	(18)
Inventories	31	(154)	(143)
Related party, net	14	—	10
Accounts payable	32	(43)	(2)
Accrued liabilities, including income taxes and other working capital	(242)	30	78
Tobacco settlement	239	92	(763)
Pension and postretirement	91	317	(185)
Other, net	316	13	42
Net cash flows from operating activities	196	1,623	1,308
Cash flows from (used in) investing activities:			
Capital expenditures	(174)	(204)	(153)
Proceeds from settlement of short-term investments	265	—	—
Proceeds from settlement of long-term investments	67	4	6
Acquisition, net of cash acquired	(17,220)	—	—
Proceeds from Divestiture	7,056	—	—
Proceeds from termination of joint venture	—	35	31
Other, net	1	(40)	3
Net cash flows used in investing activities	(10,005)	(205)	(113)
Cash flows from (used in) financing activities:			
Dividends paid on common stock	(1,583)	(1,411)	(1,335)
Repurchase of common stock	(124)	(440)	(775)
Proceeds from BAT Share Purchase	4,673	—	—
Proceeds from issuance of long-term debt, net of discounts	8,975	—	1,097
Debt issuance costs and financing fees	(70)	(79)	(18)
Principal borrowings under revolving credit facility	1,400	1,000	—
Repayments under revolving credit facility	(1,400)	(1,000)	—
Repayments of long-term debt	(450)	—	(1,035)
Principal borrowings under term-loan credit facility	—	—	500
Repayments under term-loan credit facility	—	—	(500)
Make-whole premium for early extinguishment of debt	—	—	(155)
Excess tax benefit on stock-based compensation plans	17	12	14
Net cash flows from (used in) financing activities	11,438	(1,918)	(2,207)
Effect of exchange rate changes on cash and cash equivalents	(28)	(34)	10
Net change in cash and cash equivalents	1,601	(534)	(1,002)
Cash and cash equivalents at beginning of year	966	1,500	2,502
Cash and cash equivalents at end of year	$ 2,567	$ 966	$ 1,500
Income taxes paid, net of refunds	$ 3,744	$ 974	$ 713
Interest paid	$ 510	$ 252	$ 267
Fair value of equity consideration issued in the Merger	$ 7,555	$ —	$ —

See Notes to Consolidated Financial Statements

REYNOLDS AMERICAN INC.

CONSOLIDATED BALANCE SHEETS
(Dollars in Millions)

	December 31,	
	2015	2014
Assets		
Current assets:		
Cash and cash equivalents	$ 2,567	$ 966
Short-term investments	149	—
Accounts receivable	68	116
Accounts receivable, related party	38	41
Other receivables	35	12
Inventories	1,734	1,281
Deferred income taxes, net	1,032	703
Other current assets	564	204
Total current assets	6,187	3,323
Property, plant and equipment, at cost:		
Land and land improvements	94	93
Buildings and leasehold improvements	727	729
Machinery and equipment	1,967	1,925
Construction-in-process	110	83
Total property, plant and equipment	2,898	2,830
Accumulated depreciation	(1,643)	(1,627)
Property, plant and equipment, net	1,255	1,203
Trademarks and other intangible assets, net of accumulated amortization	29,467	2,421
Goodwill	15,993	8,016
Other assets and deferred charges	322	233
	$53,224	$15,196
Liabilities and shareholders' equity		
Current liabilities:		
Accounts payable	$ 179	$ 142
Tobacco settlement accruals	2,816	1,819
Due to related party	9	1
Deferred revenue, related party	33	32
Current maturities of long-term debt	506	450
Dividends payable on common stock	514	356
Other current liabilities	1,234	744
Total current liabilities	5,291	3,544
Long-term debt (less current maturities)	16,941	4,633
Deferred income taxes, net	10,236	383
Long-term retirement benefits (less current portion)	2,265	1,997
Other noncurrent liabilities	239	117
Commitments and contingencies:		
Shareholders' equity:		
Common stock (shares issued: 2015 — 1,427,341,341; 2014 — 1,062,567,026)	—	—
Paid-in capital	18,402	6,200
Retained earnings (accumulated deficit)	188	(1,314)
Accumulated other comprehensive loss	(338)	(364)
Total shareholders' equity	18,252	4,522
	$53,224	$15,196

See Notes to Consolidated Financial Statements

REYNOLDS AMERICAN INC.

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
(Dollars in Millions, Except Per Share Amounts)

	Common Stock	Paid-In Capital	Retained Earnings (Accumulated Deficit)	Accumulated Other Comprehensive Loss	Total Shareholders' Equity
Balance at December 31, 2012	$—	$ 7,275	$(1,707)	$(311)	$ 5,257
Net income	—	—	1,718	—	1,718
Retirement benefits, net of $160 tax expense	—	—	—	248	248
Unrealized gain on long-term investments, net of $3 tax expense	—	—	—	5	5
Amortization of realized loss on hedging instruments, net of $1 tax expense	—	—	—	1	1
Cumulative translation adjustment and other, net of $12 tax expense	—	—	—	1	1
Dividends — $1.24 per share	—	—	(1,359)	—	(1,359)
Common stock repurchased	—	(775)	—	—	(775)
Equity incentive award plan and stock-based compensation	—	57	—	—	57
Excess tax benefit on stock-based compensation plans	—	14	—	—	14
Balance at December 31, 2013	—	6,571	(1,348)	(56)	5,167
Net income	—	—	1,470	—	1,470
Retirement benefits, net of $178 tax benefit	—	—	—	(277)	(277)
Unrealized gain on long-term investments, net of $1 tax expense	—	—	—	2	2
Amortization of realized loss on hedging instruments, net of $1 tax expense	—	—	—	1	1
Cumulative translation adjustment and other, net of $15 tax benefit	—	—	—	(34)	(34)
Dividends — $1.34 per share	—	—	(1,436)	—	(1,436)
Common stock repurchased	—	(440)	—	—	(440)
Equity incentive award plan and stock-based compensation	—	57	—	—	57
Excess tax benefit on stock-based compensation plans	—	12	—	—	12
Balance at December 31, 2014	—	6,200	(1,314)	(364)	4,522
Net income	—	—	3,253	—	3,253
Retirement benefits, net of $32 tax expense	—	—	—	50	50
Amortization of realized loss on hedging instruments, net of $1 tax expense	—	—	—	1	1
Cumulative translation adjustment and other, net of $12 tax benefit	—	—	—	(25)	(25)
Dividends — $1.39 per share	—	—	(1,751)	—	(1,751)
Issuance of additional shares as Merger Consideration	—	7,555	—	—	7,555
Issuance of additional shares for BAT Share Purchase	—	4,673	—	—	4,673
Common stock repurchased	—	(124)	—	—	(124)
Equity incentive award plan and stock-based compensation	—	81	—	—	81
Excess tax benefit on stock-based compensation plans	—	17	—	—	17
Balance at December 31, 2015	$—	$18,402	$ 188	$(338)	$18,252

See Notes to Consolidated Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 — Business and Summary of Significant Accounting Policies

Overview

The consolidated financial statements include the accounts of Reynolds American Inc., referred to as RAI, and its wholly owned subsidiaries. RAI's wholly owned operating subsidiaries include R. J. Reynolds Tobacco Company; Santa Fe Natural Tobacco Company, Inc., referred to as SFNTC; American Snuff Company, LLC, referred to as American Snuff Co.; R. J. Reynolds Vapor Company, referred to as RJR Vapor; Niconovum USA, Inc.; Niconovum AB; and until their sale on January 13, 2016, as described below, SFR Tobacco International GmbH, referred to as SFRTI, and various foreign subsidiaries affiliated with SFRTI.

RAI was incorporated as a holding company in the State of North Carolina on January 2, 2004, and its common stock is listed on the New York Stock Exchange, referred to as the NYSE, under the symbol "RAI." On July 30, 2004, the U.S. assets, liabilities and operations of Brown & Williamson Tobacco Corporation, now known as Brown & Williamson Holdings, Inc., referred to as B&W, an indirect, wholly owned subsidiary of British American Tobacco p.l.c., referred to as BAT, were combined with R. J. Reynolds Tobacco Company, a wholly owned operating subsidiary of R.J. Reynolds Tobacco Holdings, Inc., referred to as RJR. These July 30, 2004, transactions generally are referred to as the B&W business combination.

References to RJR Tobacco prior to July 30, 2004, relate to R. J. Reynolds Tobacco Company, a New Jersey corporation and a wholly owned subsidiary of RJR. References to RJR Tobacco on and subsequent to July 30, 2004, relate to the combined U.S. assets, liabilities and operations of B&W and R. J. Reynolds Tobacco Company, a North Carolina corporation.

On June 12, 2015, RAI acquired Lorillard, Inc., n/k/a Lorillard, LLC, referred to as Lorillard, in a cash and stock transaction, referred to as the Merger, pursuant to which a wholly owned subsidiary of RAI, referred to as Merger Sub, merged with and into Lorillard, with Lorillard surviving as a wholly owned subsidiary of RAI, all in accordance with an agreement and plan of merger, dated July 15, 2014, among RAI, Merger Sub and Lorillard, referred to as the Merger Agreement.

Also on June 12, 2015, a wholly owned subsidiary, referred to as Imperial Sub, of Imperial Tobacco Group, PLC, referred to as Imperial, acquired for approximately $7.1 billion certain assets (1) owned by RAI subsidiaries or affiliates relating to the cigarette brands WINSTON, KOOL and SALEM, and (2) owned by Lorillard subsidiaries or affiliates related to the cigarette brand MAVERICK and the "e-vapor" brand blu (including SKYCIG), as well as Lorillard's owned and leased real property, and certain transferred employees, together with associated liabilities, all in accordance with (x) an asset purchase agreement, dated July 15, 2014, as amended, referred to as the Asset Purchase Agreement, among RAI and Imperial Sub, and for certain provisions of the Asset Purchase Agreement and as guarantor of certain obligations of Imperial Sub, Imperial, and (y) a transfer agreement, dated July 15, 2014, referred to as the Transfer Agreement, between Lorillard and Imperial Sub. The transactions pursuant to the Asset Purchase Agreement and Transfer Agreement are collectively referred to as the Divestiture.

In addition, on June 12, 2015, shortly after the completion of the Merger, Lorillard Tobacco Company, LLC, a wholly owned subsidiary of Lorillard, referred to as Lorillard Tobacco, merged with and into RJR Tobacco, with RJR Tobacco continuing as the surviving entity, referred to as the Lorillard Tobacco Merger. The statements of financial position and results of operations contained in the consolidated financial statements reflect the results of the Merger and Divestiture and related transactions. For additional information on the Merger and Divestiture, and related transactions see note 2 to consolidated financial statements.

On January 13, 2016, RAI, through various subsidiaries, referred to as the Sellers, completed the sale of the international rights to the NATURAL AMERICAN SPIRIT brand name and associated trademarks, along with the international companies that distribute and market the brand outside the United States to JT International Holding BV, referred to as JTI Holding, a subsidiary of Japan Tobacco Inc., referred to as JTI, in an all-cash transaction with a value of approximately $5 billion.

The purchase agreement, dated as of September 28, 2015, between the Sellers and JTI Holding, referred to as the 2015 Purchase Agreement, contains customary representations, warranties and covenants made by the Sellers and JTI Holding, and, for certain provisions, RAI and JTI, and contains indemnification provisions, subject to customary limitations, with respect to these and other matters, including potential litigation relation to specified claims. The 2015 Purchase Agreement also contains a guarantee of Sellers' obligations by RAI, and a guarantee of JTI Holding's obligations by JTI. Further, in the 2015 Purchase Agreement, RAI has agreed not to, and agreed to cause its controlled affiliates not to, engage in the business of producing, selling, distributing and

developing natural, organic and additive-free combustible tobacco cigarettes and roll-your-own or make-your-own tobacco products outside of the United States, and JTI has agreed not to, and agreed to cause its controlled affiliates not to, engage in the conduct of such business in the United States, in each case, for five years following the closing of the transaction.

The transaction does not include the rights to the NATURAL AMERICAN SPIRIT brand name and associated trademarks in the U.S. market, U.S. duty-free locations, and U.S. territories or in U.S. military outlets, all of which have been retained by SFNTC. With this transaction completed, the international rights to nearly all of RAI's operating companies' cigarette trademarks are now owned by international tobacco companies. For additional information on the transaction, see note 4 and note 22 to consolidated financial statements.

RAI's reportable operating segments are RJR Tobacco, Santa Fe and American Snuff. The RJR Tobacco segment consists principally of the primary operations of R. J. Reynolds Tobacco Company. The Santa Fe segment consists of the domestic operations of SFNTC. The American Snuff segment consists of the primary operations of American Snuff Co. Included in All Other, among other RAI subsidiaries, are RJR Vapor, Niconovum USA, Inc., Niconovum AB, and until their sale on January 13, 2016, as described above, SFRTI, and various foreign subsidiaries affiliated with SFRTI. The segments were identified based on how RAI's chief operating decision maker allocates resources and assesses performance. Certain of RAI's operating subsidiaries have entered into intercompany agreements for products or services with other subsidiaries. As a result, certain activities of an operating subsidiary may be included in a different segment of RAI.

RAI's operating subsidiaries primarily conduct their business in the United States.

Basis of Presentation

The preparation of the consolidated financial statements in conformity with accounting principles generally accepted in the United States of America, referred to as GAAP, requires estimates and assumptions to be made that affect the reported amounts in the consolidated financial statements and accompanying notes. Volatile credit and equity markets, changes to regulatory and legal environments, and consumer spending may affect the uncertainty inherent in such estimates and assumptions. Actual results could materially differ from those estimates. All material intercompany balances have been eliminated.

Certain reclassifications were made to conform prior years' financial statements to the current presentation. Certain amounts presented in note 13 are rounded in the aggregate and may not sum from the individually presented components. All dollar amounts, other than per share amounts, are presented in millions, except for amounts set forth in note 13 and as otherwise noted.

Business Combination

RAI accounts for business combination transactions in accordance with the Financial Accounting Standards Board, referred to as FASB, Accounting Standards Codification 805, *Business Combinations*, referred to as ASC 805. RAI allocates the cost of an acquisition to the assets acquired and liabilities assumed based on their fair values as of the acquisition date. Any excess of the purchase price over the estimated fair value of net assets acquired is recorded as goodwill. Determining the fair value of these items requires management's judgment and may require utilization of independent valuation experts to assist with such valuations. These valuations involve the use of significant estimates and assumptions with respect to the timing and amounts of future cash flows, discount rates, market prices, and asset lives, among other items. The judgments made in the determination of the estimated fair value of the assets acquired and the liabilities assumed as well as the estimated useful life of each asset and the duration of each liability can materially impact the financial statements in periods after the acquisition, such as depreciation, amortization, or in certain situations, impairment charges.

The fair value of acquired intangible assets measured on a nonrecurring basis, was determined based on inputs that are unobservable and significant to the overall fair value measurement. As such, acquired intangible assets are classified as Level 3. RAI engaged the services of a third party valuation expert to assist in determining the fair value of acquired trademarks and customer lists. The acquired trademarks and customer lists were valued utilizing the income approach and were based on a discounted cash flow valuation model. This approach utilized unobservable factors, such as royalty rate, projected revenues and a discount rate, applied to the estimated cash flows. The determination of the discount rate was based on a cost of equity model, using a risk-free rate, adjusted by a stock beta-adjusted risk premium and size premium.

The fair value of acquired long-term debt was determined based on significant inputs that are observable either directly or indirectly, and are quoted prices for similar instruments in active markets or quoted prices for

identical or similar instruments in markets that are not active. As such, acquired long-term debt is classified as Level 2. RAI engaged the services of a financial institution in determining the fair value of acquired long-term debt. The acquired long-term debt was valued utilizing market quotes, credit spreads and discounted cash flows, as appropriate. RAI performed its own independent valuation to assess the reasonableness of that calculated by the financial institution.

As a market participant, RAI determined the fair value of inventories and property, plant and equipment utilizing internal resources and external experts. The fair value of finished goods inventories was determined using selling price less estimated costs to dispose. The fair value of other inventories, primarily leaf tobacco acquired, was based on recent costs for similar inventory purchased by RAI and its subsidiaries or historical cost as appropriate. To fair value property, plant and equipment, which consisted primarily of machinery used in the manufacture of cigarettes, RAI utilized internal engineering resources and external vendor experts familiar with pricing for similar machinery on the secondary market. The fair value of long-term retirement benefits represents the funded status of the employee benefit plans assumed by RAI in the Merger. RAI engaged its actuaries to determine the fair value of the projected benefit obligations at the date of the Merger utilizing management's assumptions and estimates relative to the benefit plans acquired. For the fair value of benefit plan assets, an independent valuation expert was engaged, in addition to internal treasury resources, to project the fair value of the benefit plan assets at the Merger date.

For further information related to accounting for the Merger and Divestiture, see note 2 to consolidated financial statements.

Stock Split

On July 27, 2015, RAI's board of directors approved a two-for-one stock split of RAI's common stock, in the form of a 100 percent stock dividend, which was issued on August 31, 2015, to shareholders of record on August 17, 2015. Shareholders of record received one additional share of RAI common stock for each share owned. All current and prior period share and per share amounts have been adjusted to reflect this stock split, unless otherwise noted.

Cash and Cash Equivalents

Cash balances are recorded net of book overdrafts when a bank right-of-offset exists. All other book overdrafts are recorded in accounts payable. Cash equivalents may include money market funds, commercial paper and time deposits in major institutions to minimize investment risk. As short-term, highly liquid investments readily convertible to known amounts of cash, with remaining maturities of three months or less at the time of purchase, cash equivalents have carrying values that approximate fair values.

Fair Value Measurement

RAI determines the fair value of assets and liabilities, if any, using a fair value hierarchy that distinguishes between market participant assumptions based on market data obtained from sources independent of the reporting entity, and the reporting entity's own assumptions about market participant assumptions based on the best information available in the circumstances.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, essentially an exit price.

The levels of the fair value hierarchy are:

Level 1: inputs are quoted prices, unadjusted, in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.

Level 2: inputs are other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. A Level 2 input must be observable for substantially the full term of the asset or liability.

Level 3: inputs are unobservable and reflect the reporting entity's own assumptions about the assumptions that market participants would use in pricing the asset or liability.

Investments

RAI's financial assets other than cash equivalents are classified as available-for-sale and are carried at fair value. RAI reviews its investments on a quarterly basis to determine if it is probable that RAI will realize some portion of the unrealized loss and to determine the classification of the impairment as temporary or other-than-temporary. For those investments which RAI does not intend to sell and for which it is more likely than not that RAI will not be required to sell prior to recovery, RAI recognizes the credit loss component of an other-than-temporary impairment of its debt securities in earnings and the noncredit component in accumulated other comprehensive loss. All losses deemed to be other than temporarily impaired are recorded in earnings.

RAI evaluates its investments for possible impairment based on current economic conditions, credit loss experience and other criteria. The evaluation of investments for impairment requires significant judgments, including:

- the identification of potentially impaired securities;
- the determination of their estimated fair value;
- the assessment of whether any decline in estimated fair value is other-than-temporary; and
- the likelihood of selling before recovery.

Inventories

Inventories are stated at the lower of cost or market. The cost of tobacco inventories is determined principally under the last-in, first-out, or LIFO, method and is calculated at the end of each year. The cost of work in process and finished goods includes materials, direct labor, variable costs and overhead and full absorption of fixed manufacturing overhead. Stocks of tobacco, which have an operating cycle that exceeds 12 months due to aging requirements, are classified as current assets, consistent with recognized industry practice. The remaining inventories not valued under LIFO are valued under the first-in, first-out method.

Long-lived Assets

Long-lived assets, such as property, plant and equipment, trademarks and other intangible assets with finite lives, are reviewed for impairment whenever events or changes in circumstances indicate that the book value of the asset may not be recoverable. Impairment of the carrying value of long-lived assets would be indicated if the best estimate of future undiscounted cash flows expected to be generated by the asset grouping is less than its carrying value. If an impairment is indicated, any loss is measured as the difference between estimated fair value and carrying value and is recognized in operating income.

Property, Plant and Equipment

Property, plant and equipment are recorded at cost and depreciated using the straight-line method over the estimated useful lives of the assets. Useful lives range from 20 to 50 years for buildings and improvements, and from 3 to 30 years for machinery and equipment. The cost and related accumulated depreciation of assets sold or retired are removed from the accounts and the gain or loss on disposition is recognized in operating income. Depreciation expense was $104 million, $95 million and $98 million for the years ended December 31, 2015, 2014 and 2013, respectively.

Software Costs

Computer software and software development costs incurred in connection with developing or obtaining computer software for internal use that has an extended useful life are capitalized. These costs are amortized over their estimated useful life, which is typically five years or less. The following is a summary of balances and expenses for software costs as of and for the years ended December 31:

Balances:

	2015	2014
Unamortized software costs balance	$37	$41
Software costs — capitalized or included in construction-in-process	13	5

Expenses:

	2015	2014	2013
Software amortization expense	$17	$15	$17

Intangible Assets

Intangible assets include goodwill, trademarks and other intangible assets and are capitalized when acquired. The determination of fair value involves considerable estimates and judgment. In particular, the fair value of a reporting unit involves, among other things, developing forecasts of future cash flows, determining an appropriate discount rate, and when goodwill impairment is implied, determining the fair value of individual assets and liabilities, including unrecorded intangibles. Although RAI believes it has based its impairment testing and impairment charges of its intangibles on reasonable estimates and assumptions, the use of different estimates and assumptions could result in materially different results. If the current legal and regulatory environment, business or competitive climate worsens, or RAI's operating companies' strategic initiatives adversely affect their financial performance, the fair value of goodwill, trademarks and other intangible assets could be impaired in future periods. Goodwill, trademarks and other intangible assets with indefinite lives are not amortized, but are tested for impairment annually, in the fourth quarter, and more frequently if events and circumstances indicate that the asset might be impaired.

Accounting for Derivative Instruments and Hedging Activities

RAI measures any derivative instruments, including certain derivative instruments embedded in other contracts, at fair value and records them in the balance sheet as either an asset or liability. Changes in fair value of derivatives are recorded in earnings unless hedge accounting criteria are met. For derivatives designated as fair value hedges, the changes in fair value of both the derivative instrument and the hedged item are recorded in earnings. For derivatives designated as cash flow hedges, the effective portions of changes in the fair value of the derivative are reported in accumulated other comprehensive loss. The ineffective portions of hedges are recognized in earnings in the current period.

RAI formally assesses at inception of the hedge and on an ongoing basis, whether each derivative is highly effective in offsetting changes in fair values or cash flows of the hedged item, and formally designates as a hedge those derivatives that qualify for hedge accounting. If it is determined that a derivative is not highly effective as a hedge or if a derivative ceases to be a highly effective hedge, RAI will discontinue hedge accounting prospectively. Any unrecognized gain or loss will be deferred and recognized into earnings as the formerly hedged item is recognized in earnings. At December 31, 2015 and 2014, RAI had no derivative instruments. At December 31, 2015, RJR Tobacco had derivative instruments consisting of the interest rate swap agreements assumed in connection with the Merger.

Revenue Recognition

Revenue from product sales is recognized when persuasive evidence of an arrangement exists, delivery has occurred, the seller's price to the buyer is fixed or determinable, and collectability is reasonably assured. These criteria are generally met when title and risk of loss pass to the customer. Payments received in advance of shipments are deferred and recorded in other accrued liabilities until shipment occurs. Certain sales of leaf to a related party, considered as bill-and-hold for accounting purposes, are recorded as deferred revenue when all of the above revenue recognition criteria are met except delivery, postponed at the customer's request. Revenue is subsequently recognized upon delivery. The revenues recorded are presented net of excise tax collected on behalf of government authorities.

Shipping and handling costs are classified as cost of products sold. Net sales include certain sales incentives, including retail discounting, promotional allowances and coupons.

Cost of Products Sold

RJR Tobacco (itself, and as successor by merger to Lorillard Tobacco) and SFNTC are participants in the Master Settlement Agreement, referred to as the MSA, and RJR Tobacco (itself, and as successor by merger to Lorillard Tobacco) is a participant in the other state settlement agreements with the States of Mississippi, Florida, Texas and Minnesota, which together with the MSA are collectively referred to as the State Settlement Agreements. RJR Tobacco's and SFNTC's obligations and the related expense charges under these agreements are subject to adjustments based upon, among other things, the volume of cigarettes sold by the operating

subsidiaries, their relative market share, operating profit and inflation. Since relative market share is based on cigarette shipments, the best estimate of the allocation of charges to RJR Tobacco and SFNTC under these agreements is recorded in cost of products sold as the products are shipped. Included in these adjustments is the MSA non-participating manufacturer adjustment, referred to as the NPM Adjustment, that potentially reduces the annual payment obligation of RJR Tobacco, SFNTC and other participating manufacturers, referred to as the PMs. Adjustments to these estimates are recorded in the period that the change becomes probable and the amount can be reasonably estimated. American Snuff Co. is not a participant in the State Settlement Agreements.

Cost of products sold includes the expenses for the State Settlement Agreements; the user fees charged by the U.S. Food and Drug Administration, referred to as the FDA; and the federal tobacco quota buyout that expired in 2014. These expenses were as follows for the years ended December 31:

	2015	2014	2013
State Settlement Agreements	$2,403	$1,917	$1,819
FDA user fees	174	135	127
Federal tobacco quota buyout	—	163	209

In 2012, RJR Tobacco, Lorillard Tobacco and certain other PMs, including SFNTC, entered into a term sheet, referred to as the Term Sheet, with 17 states, the District of Columbia and Puerto Rico to settle certain claims related to the NPM Adjustment. The Term Sheet resolves claims related to volume years from 2003 through 2012 and puts in place a revised method to determine future adjustments from 2013 forward as to jurisdictions that join the agreement. On March 12, 2013, a single, nationwide arbitration panel of three former federal judges, referred to as the Arbitration Panel, hearing the dispute related to the 2003 NPM Adjustment (and related matters) issued an order, referred to as the Order, authorizing the implementation of the Term Sheet. In addition, after the Order, one additional state signed the Term Sheet on April 12, 2013; and, two additional states signed the Term Sheet on May 24, 2013. The Term Sheet is binding on all signatories.

Based on the jurisdictions bound by the Term Sheet through December 31, 2013, RJR Tobacco and SFNTC, collectively, will receive credits, currently estimated to total approximately $1.1 billion, with respect to their NPM Adjustment claims for the period from 2003 through 2012. These credits will be applied against annual payments under the MSA over a five-year period, which commenced with the April 2013 MSA payment. As a result of this binding Order, expenses for the MSA were reduced by $219 million for the year ended December 31, 2013. As a result of the Lorillard Tobacco Merger, RJR Tobacco will receive approximately $22 million of additional credits, attributable to Lorillard Tobacco, which will be applied against annual payments in 2016 and 2017.

In June 2014, two additional states agreed to settle the NPM Adjustment disputes on similar terms as set forth in the Term Sheet, except for certain provisions related to the determination of credits to be received by the PMs. RJR Tobacco and SFNTC, collectively, will receive credits, currently estimated to total approximately $170 million, with respect to their NPM Adjustment claims from 2003 through 2012. The credits related to these two states will be applied against annual payments under the MSA over a five-year period effectively beginning with the April 2014 MSA payment. As a result, expenses for the MSA were reduced by $34 million for the year ended December 31, 2014. As a result of the Lorillard Tobacco Merger, RJR Tobacco will receive approximately $5 million of additional credits, attributable to Lorillard Tobacco, which will be applied against annual payments over the next three years.

As a result of meeting the performance requirements associated with the Term Sheet, RJR Tobacco and Santa Fe, collectively, recognized additional credits of $282 million, $311 million and $264 million for the years ended December 31, 2015, 2014 and 2013, respectively. RJR Tobacco expects to recognize additional credits through 2017, and Santa Fe expects to recognize additional credits through 2016.

In September 2013, the Arbitration Panel ruled six states had not diligently enforced their qualifying statutes in 2003 related to the NPM Adjustment. Based on the status of the various challenges filed by the non-diligent states to certain rulings of the Arbitration Panel related to the 2003 NPM Adjustment claim, as of December 31, 2015, three of the non-diligent states are no longer challenging the findings of non-diligence entered against them by the Arbitration Panel. As a result, a certain portion of the NPM Adjustment claim for 2003 from these three states is now certain and can be estimated. Consequently, RJR Tobacco recognized $93 million as a reduction of cost of products sold for the year ended December 31, 2015.

On October 20, 2015, RJR Tobacco and certain other PMs (including SFNTC) entered into a settlement agreement, referred to as the NY Settlement Agreement, with the State of New York to settle certain claims related to the MSA NPM Adjustment. The NY Settlement Agreement resolves NPM Adjustment claims related

to payment years from 2004 through 2014 and puts in place a new method to determine future adjustments from 2015 forward as to New York. RJR Tobacco and SFNTC, collectively, will receive credits, currently estimated to total approximately $290 million, plus interest, with respect to their NPM Adjustment claims for the period 2004 through 2014. These credits will be applied against annual payments under the MSA over a four-year period, commencing with the annual MSA payment due in April 2016. As a result of the NY Settlement Agreement, expenses for the MSA were reduced by $15 million for the year ended December 31, 2015, recognizing the credit that reduces the April 2016 MSA payment. RJR Tobacco and SFNTC will recognize the additional credits in 2016 through 2018, subject to meeting various performance obligations associated with the NY Settlement Agreement.

For additional information related to the NPM Adjustment settlement, see "— Litigation Affecting the Cigarette Industry — State Settlement Agreements — Enforcement and Validity; Adjustments" in note 13.

Advertising

Advertising costs, which are expensed as incurred, were $140 million, $140 million and $110 million for the years ended December 31, 2015, 2014 and 2013, respectively.

Research and Development

Research and development costs, which are expensed as incurred, were $107 million, $88 million and $72 million for the years ended December 31, 2015, 2014 and 2013, respectively.

Income Taxes

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Interest and penalties related to uncertain tax positions are accounted for as tax expense. Federal income taxes for RAI and its subsidiaries are calculated on a consolidated basis. State income taxes for RAI and its subsidiaries are primarily calculated on a separate return basis.

RAI accounts for uncertain tax positions which require that a position taken or expected to be taken in a tax return be recognized in the financial statements when it is more likely than not (a likelihood of more than 50%) that the position would be sustained upon examination by tax authorities. A recognized tax position is then measured at the largest amount of benefit that is greater than 50% likely of being realized upon ultimate settlement.

Stock-Based Compensation

Stock-based compensation expense is recognized for all forms of share-based payment awards, including shares issued to employees under restricted stock units.

Litigation

RAI discloses information concerning litigation for which an unfavorable outcome is more than remote. RAI and its subsidiaries record their legal expenses and other litigation costs and related administrative costs as selling, general and administrative expenses as these costs are incurred. RAI and its subsidiaries will record any loss related to litigation at such time as an unfavorable outcome becomes probable and the amount can be reasonably estimated on an individual case-by-case basis. When the reasonable estimate is a range, the recorded loss will be the best estimate within the range. If no amount in the range is a better estimate than any other amount, the minimum amount of the range will be recorded.

Pension and Postretirement

Pension and postretirement benefits require balance sheet recognition of the net asset or liability for the overfunded or underfunded status of defined benefit pension and other postretirement benefit plans, on a plan-by-plan basis, and recognition of changes in the funded status in the year in which the changes occur.

Actuarial gains or losses are changes in the amount of either the benefit obligation or the fair value of plan assets resulting from experience different from that assumed or from changes in assumptions. Differences between actual results and actuarial assumptions are accumulated and recognized as a mark-to-market adjustment, referred to as an MTM adjustment, to the extent such accumulated net gains and losses are in excess of 10% of the greater of the fair value of plan assets or benefit obligations, referred to as the corridor. Actuarial gains and losses outside the corridor are generally recognized annually as of December 31, or when a plan is remeasured during an interim period.

Prior service costs of pension benefits, which are changes in benefit obligations due to plan amendments, are amortized on a straight-line basis over the average remaining service period for active employees, or average remaining life expectancies for inactive employees if most of the plan obligations are due to inactive employees. Prior service costs of postretirement benefits, which are changes in benefit obligations due to plan amendments, are amortized on a straight-line basis over the expected service period to full eligibility age for active employees, or average remaining life expectancies for inactive employees if most of the plan obligations are due to inactive employees.

Recently Issued Accounting Pronouncements

In May 2014, the FASB issued amended guidance that replaces most existing GAAP revenue recognition guidance. The amended guidance is effective for RAI for interim and annual reporting periods beginning on January 1, 2017, and permits the use of either the retrospective or cumulative effect transition method. Early adoption is prohibited. RAI is evaluating the effect this guidance will have on its consolidated financial statements and related disclosures.

In January 2015, the FASB issued amended guidance which simplifies income statement presentation by eliminating the concept of extraordinary items. Previously, events or transactions that were both unusual in nature and infrequent in occurrence for a business entity were considered to be extraordinary items and required separate presentation, net of tax, after income from continuing operations. The guidance does not change the requirement to disclose items which are unusual in nature or infrequent in occurrence as a component of continuing operations or in the footnotes. The guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2015. The adoption of the amended guidance is not expected to have a material impact on RAI's results of operations, cash flows or financial position.

In February 2015, the FASB issued amendments to the consolidation standard that reduce the number of consolidation models. The amended standard changes the way reporting entities examine partnerships and similar entities, evaluate service providers and decision makers as they relate to a variable interest entity, referred to as a VIE, and examine how related party interests in a VIE can affect the consolidation of that VIE. The guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2015. The adoption of the amended guidance is not expected to have a material impact on RAI's results of operations, cash flows or financial position.

In April 2015, the FASB issued amended guidance to simplify the presentation of debt issuance costs. The current guidance requires debt issuance costs to be reported on the balance sheet as an asset and amortized as interest expense. The amended guidance requires debt issuance costs to be presented as a direct reduction of the debt liability it is associated with similar to the way debt discounts are presented. This guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2015. The standard requires retrospective application for all prior periods presented. The adoption of the amended guidance is not expected to have a material impact on RAI's results of operations, cash flows or financial position.

In April 2015, the FASB issued new guidance for determining if an arrangement for cloud services includes a license of software. This new guidance does not change the accounting standard for cloud service providers, but does base the criteria for determining if a license of software is part of the arrangement based on the existing guidance. If a license of software is present in the arrangement, the fee associated with the license portion will be capitalized when the criteria for capitalization of internal-use software are met. This guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2015. The adoption of the amended guidance is not expected to have a material impact on RAI's results of operations, cash flows or financial position.

In September 2015, the FASB issued guidance requiring an acquirer in a business combination to recognize adjustments to provisional amounts that are identified during the measurement period in the reporting period in which the adjustment amounts are determined and that the acquirer record, in the same period's financial

statements, the effect on earnings of changes in depreciation, amortization, or other income effects, if any, as a result of the change to the provisional amounts, calculated as if the accounting had been completed at the acquisition date. In addition, an entity shall disclose the portion of the amount recorded in current-period earnings by line item that would have been recorded in previous reporting periods if the adjustment to the provisional amounts had been recognized as of the acquisition date. Current guidance requires that during the measurement period, the acquirer retrospectively adjust the provisional amounts recognized at the acquisition date with a corresponding adjustment to goodwill. This new guidance eliminates the requirement to retrospectively account for those adjustments. The guidance is effective for fiscal years, including interim periods within those fiscal years, beginning after December 15, 2015. The adoption of this guidance is not expected to have a material effect on RAI's results of operations, cash flows or financial position.

In November 2015, the FASB issued amended guidance requiring that deferred income tax balances on the consolidated balance sheet be classified as non-current. Current guidance requires deferred tax balances be classified as either current or non-current in accordance with the classification of the underlying attributes. The current requirement that deferred tax liabilities and assets of an entity be offset and presented as a single amount is not affected by this amendment. The amended guidance is effective for financial statements issued for fiscal years beginning after December 15, 2016, and interim periods within those fiscal years. Earlier adoption is permitted. The amended guidance may be applied either prospectively to all deferred tax liabilities and assets or retrospectively to all periods presented. RAI is evaluating the effect this guidance will have on its results of operations, cash flows or financial position.

Note 2 — Merger, Divestiture and BAT Share Purchase

Merger

On June 12, 2015, the Merger was completed, with Merger Sub merging with and into Lorillard and Lorillard surviving as a wholly owned subsidiary of RAI. Pursuant to the Merger Agreement, each share of Lorillard common stock (other than treasury shares held by Lorillard and any shares of Lorillard common stock owned by any Lorillard subsidiary, RAI or Merger Sub) was converted into the right to receive (1) 0.2909 of a share of RAI common stock, prior to giving effect to the stock split, plus (2) $50.50 in cash (the foregoing collectively referred to as the Merger Consideration). RAI issued 104,706,847 shares of RAI common stock at a price of $72.15 per share, prior to giving effect to the stock split, to Lorillard shareholders in the Merger. After giving effect to the stock split, RAI issued 209,413,694 shares of RAI common stock to Lorillard shareholders in the Merger.

As a part of the Merger, RAI acquired the premium cigarette brand, NEWPORT, which is the top-selling menthol and second largest selling cigarette brand overall in the United States. In addition to NEWPORT, RAI acquired three additional brand families marketed under the KENT, TRUE and OLD GOLD brand names.

In accordance with ASC 805, the Merger has been accounted for using the acquisition method of accounting with RAI considered the acquirer of Lorillard. RAI recorded assets acquired, including identifiable intangible assets, and liabilities assumed, from Lorillard at their respective fair values at the date of completion of the Merger. Any excess of the purchase price over the net fair value of such assets and liabilities will be recorded as goodwill.

Purchase Price

The purchase price of $25.8 billion consisted of the Merger Consideration together with the payment of certain Lorillard equity awards and certain change of control payments as follows:

Fair value of RAI common stock issued	$ 7,555
Cash paid to Lorillard shareholders at $50.50 per share	18,205
Cash paid for Lorillard stock options and stock appreciation rights	73
Purchase price	$25,833

Allocation of Purchase Price

The table below presents the purchase price as allocated to the assets acquired and liabilities assumed in the Merger.

	Preliminary June 12, 2015	Measurement Period Adjustments	Final Adjusted June 12, 2015
Assets			
Cash and cash equivalents	$ 1,059	$ (1)	$ 1,058
Short-term investments	347	—	347
Accounts and other receivables	45	2	47
Inventories	583	(7)	576
Income taxes receivable	114	21	135
Other current assets	1,361	312	1,673
Property, plant and equipment	94	(12)	82
Trademarks and other intangible assets	26,242	1,201	27,443
Goodwill	10,852	(999)	9,853
Other assets and deferred charges	210	(3)	207
Liabilities			
Tobacco settlement accruals	753	2	755
Other current liabilities	507	95	602
Long-term debt (less current maturities)	3,951	(56)	3,895
Deferred income taxes, net	9,536	462	9,998
Long-term retirement benefits (less current portion)	263	11	274
Other noncurrent liabilities	64	—	64
Allocation of purchase price	$25,833	$ —	$25,833

The allocation of the purchase price reflected in the accompanying financial statements is based upon estimates and assumptions. Goodwill generated from the acquisition is primarily attributable to the establishment of deferred tax liabilities associated with the trademarks acquired and the expected synergies from future growth, and is allocated to the reporting unit that is expected to benefit from these synergies. The $9,853 million allocated to goodwill represents the excess of the allocation of the purchase price over the fair value of assets acquired and liabilities assumed, which amount has been allocated to the RJR Tobacco segment, and will be non-deductible for tax purposes.

During the fourth quarter of 2015, RAI finalized its purchase price allocation and obtained new fair value information related to the assets acquired and liabilities assumed, including the fair value of the trademarks and other intangible assets. The final allocation of the purchase price is based on facts and circumstances that existed at June 12, 2015, and, if known then, would have affected the amounts recognized at that date. In accordance with ASC 805, measurement period adjustments are not included in current earnings, but recognized with a corresponding adjustment to goodwill. As a result, RAI adjusted the preliminary allocation of the purchase price initially recorded at June 12, 2015, to reflect these measurement period adjustments.

The results of operations of the acquired Lorillard brands are included in RAI's consolidated statements of income from the date of acquisition and include $2.7 billion of total net sales for the year ended December 31, 2015, and are included in the RJR Tobacco segment's financial results. RAI does not maintain discrete financial information on a brand basis in order to determine the impact to net income for the periods presented. In addition, as a result of the acquisition, $9 billion of debt was issued and approximately $3.9 billion of Lorillard Tobacco debt was assumed (at fair value). The interest expense related to the acquisition was approximately $282 million for the year ended December 31, 2015.

Divestiture

On June 12, 2015, the Divestiture was completed, and Imperial Sub acquired the cigarette brands WINSTON, KOOL and SALEM, previously owned by RAI subsidiaries and included in the RJR Tobacco segment, as well as the cigarette brand MAVERICK and the "e-vapor" brand blu (including SKYCIG), previously owned by Lorillard subsidiaries, and other assets and certain liabilities, including inventory, fixed assets and employee benefit plans, for an aggregate purchase price of approximately $7.1 billion. A summary of the pre-tax gain is as follows:

Purchase price	$ 7,056
Net assets and liabilities divested	(2,026)
Goodwill associated with divested RJR Tobacco brands	(1,849)
Gain on Divestiture	$ 3,181

BAT Share Purchase and Other

In connection with the Merger and Divestiture, on July 15, 2014, RAI, BAT, and for limited purposes only, B&W, entered into a subscription and support agreement, referred to as the Subscription Agreement, pursuant to which BAT agreed to subscribe for and purchase, directly or indirectly through one or more of its wholly owned subsidiaries, simultaneously with the completion of the Merger and at a price of approximately $4.7 billion in the aggregate, shares of RAI common stock such that BAT, directly or indirectly through its affiliates, would maintain its approximately 42% beneficial ownership in RAI (the foregoing purchase is referred to as the BAT Share Purchase).

On June 12, 2015, concurrently with the completion of the Merger and Divestiture and pursuant to the Subscription Agreement, BAT indirectly (through a wholly owned subsidiary) purchased 77,680,259 shares of RAI common stock, prior to giving effect to the stock split, for approximately $4.7 billion, which was sufficient for BAT and its subsidiaries collectively to maintain their approximately 42% beneficial ownership in RAI. Upon completion of the transactions on June 12, 2015, BAT and its subsidiaries collectively owned 301,014,278 shares, prior to giving effect to the stock split, or approximately 42%, of RAI's outstanding common stock. After giving effect to the stock split, BAT indirectly purchased 155,360,518 shares of RAI common stock, and BAT and its subsidiaries collectively own 602,028,556 shares of RAI common stock.

RAI financed the cash portion of the Merger Consideration and related fees and expenses with (1) the net proceeds from a public offering of $9 billion aggregate principal amount of newly issued RAI senior notes, (2) the proceeds from the Divestiture, (3) the proceeds from the BAT Share Purchase and (4) available cash. Transaction related costs of $54 million and $38 million, for the years ended December 31, 2015 and 2014, respectively, were expensed as incurred and included in selling, general and administrative expenses in RAI's consolidated statements of income.

Pro forma financial information (unaudited)

The following unaudited pro forma consolidated financial information presents the combined results of operations of RAI and Lorillard as if the Merger and Divestiture had occurred at the beginning of 2014 and includes non-recurring pro forma adjustments that were directly attributable to the Merger and Divestiture. Pro forma net income includes adjustments for acquisition-related costs. Pro forma net income per share includes the impact of the issuance of RAI common stock in the BAT Share Purchase and as part of the Merger Consideration.

	For the Years Ended December 31,	
	2015	**2014**
Net sales	$12,079	$11,275
Net income	2,331	1,997
Net income per share:		
Basic income per share:		
Net income	$ 1.63	$ 1.40
Diluted income per share:		
Net income	$ 1.63	$ 1.39

The unaudited pro forma results do not reflect cost savings or synergies from operating efficiencies or the effect of the incremental costs incurred in the Merger or Divestiture. Accordingly, these unaudited pro forma results are presented for informational purposes only and are not necessarily indicative of what the actual results of operations of the combined company would have been if the Merger and Divestiture had occurred at the beginning of the periods presented, nor are they indicative of future results of operations.

Note 3 — Fair Value Measurement

Fair Value of Financial Assets and Liabilities

Financial assets carried at fair value as of December 31, were as follows:

	2015				2014			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Cash and cash equivalents:								
Cash equivalents	$2,454	$—	$—	$2,454	$883	$—	$—	$883
Short-term investments:								
Corporate debt securities	—	96	—	96	—	—	—	—
U.S. Governmental agency obligations	—	43	—	43	—	—	—	—
Commercial paper	—	10	—	10	—	—	—	—
Other assets and deferred charges:								
Auction rate securities	—	—	79	79	—	—	79	79
Mortgage-backed security	—	—	10	10	—	—	12	12
Marketable equity security	1	—	—	1	2	—	—	2
Interest rate swaps	—	53	—	53	—	—	—	—

There were no transfers between the levels during the years ended December 31, 2015 and 2014.

RAI's short-term investments include corporate debt securities, U.S. Government agency obligations and commercial paper, which were acquired as part of the Merger. The fair value of these investments, classified as Level 2, utilized quoted prices for identical assets in less active markets or quoted prices for similar assets in active markets. The fair value of the interest rate swaps, classified as Level 2, utilized a market approach model using the notional amount of the interest rate swaps and observable inputs of time to maturity and market interest rates.

For the investments that were acquired as part of the Merger, the difference between the amortized cost basis and the fair value of major security types was not material as of December 31, 2015. There are no other-than-temporary impairment losses for the year ended December 31, 2015. The unrealized gains and losses, net of tax, were included in accumulated other comprehensive loss in RAI's consolidated balance sheet as of December 31, 2015.

RAI has investments in auction rate securities linked to corporate credit risk, investments in auction rate securities related to financial insurance companies, an investment in a mortgage-backed security and an investment in a marketable equity security. The unrealized gains and losses, net of tax, were included in accumulated other comprehensive loss in RAI's consolidated balance sheets as of December 31, 2015 and 2014. The funds associated with the auction rate securities will not be accessible until a successful auction occurs or a buyer is found.

In determining if the difference between amortized cost and estimated fair value of the auction rate securities or the mortgage-backed security was deemed either temporarily or other-than-temporarily impaired, RAI evaluated each type of long-term investment using a set of criteria, including decline in value, duration of the decline, period until anticipated recovery, nature of investment, probability of recovery, financial condition and near-term prospects of the issuer, RAI's intent and ability to retain the investment, attributes of the decline in value, status with rating agencies, status of principal and interest payments and any other issues related to the underlying securities. To assess credit losses, RAI uses historical default rates, debt ratings, credit default swap spreads and recovery rates. RAI has the intent and ability to hold these investments for a period of time sufficient to allow for the recovery in market value. No other-than-temporary losses were recognized in 2015, 2014 or 2013 related to these investments.

All of the fair values of the auction rate securities, classified as Level 3, are linked to the longer-term credit risk of a diverse range of corporations, including, but not limited to, corporations in the manufacturing, financial and insurance sectors. The fair value was determined by utilizing an income approach model, which was based upon the weighted average present value of future cash payments, given the probability of certain events occurring within the market. RAI considers the market for its auction rate securities to be inactive. The income approach model utilized observable inputs, including the London interbank offered rate, referred to as LIBOR, based interest rate curves, corporate credit spreads and corporate ratings/market valuations. Additionally,

unobservable factors incorporated into the model included default probability assumptions based on historical migration tables, various default recovery rates and how these factors changed as ratings on the underlying collateral migrated from one level to another. As related to the unobservable factors, substantial changes, relative to historical trends, of the levels of corporate defaults or default recovery rates would impact the fair value measurement of these securities. Maturity dates for the auction rate securities begin in 2017.

The fair value for the mortgage-backed security, classified as Level 3, utilized a market approach and was based upon the calculation of an overall weighted average valuation, derived from the actual, or modeled, market pricing of the specific collateral. The market approach utilized actual pricing inputs when observable and modeled pricing, based upon changes in observable market pricing, when unobservable. Substantial changes in the observable market pricing would directly impact the unobservable pricing and the fair value measurement of this security. RAI has deemed the market for its mortgage-backed security to be inactive. The maturity of the mortgage-backed security has been extended to March 2016, with the annual option to extend an additional year. Given the underlying collateral and RAI's intent to continue to extend this security, it is classified as a noncurrent asset.

Financial assets classified as Level 3 investments were as follows:

	December 31, 2015			December 31, 2014		
	Cost	Gross Unrealized Loss (1)	Estimated Fair Value	Cost	Gross Unrealized Loss (1)	Estimated Fair Value
Auction rate securities	$ 99	$(20)	$79	$ 99	$(20)	$79
Mortgage-backed security	16	(6)	10	18	(6)	12
	$115	$(26)	$89	$117	$(26)	$91

(1) Unrealized losses, net of tax, are reported in accumulated other comprehensive loss in RAI's consolidated balance sheets as of December 31, 2015 and 2014.

The changes in the Level 3 investments were as follows:

	2015			2014		
	Auction Rate Securities			Auction Rate Securities		
	Cost	Gross Unrealized Gain (Loss)	Estimated Fair Value	Cost	Gross Unrealized Gain (Loss)	Estimated Fair Value
Balance as of January 1	$99	$(20)	$79	$99	$(23)	$76
Unrealized gain	—	—	—	—	3	3
Balance as of December 31	$99	$(20)	$79	$99	$(20)	$79

	2015			2014		
	Mortgage-Backed Security			Mortgage-Backed Security		
	Cost	Gross Unrealized Gain (Loss)	Estimated Fair Value	Cost	Gross Unrealized Gain (Loss)	Estimated Fair Value
Balance as of January 1	$18	$ (6)	$12	$20	$ (7)	$13
Unrealized gain	—	—	—	—	1	1
Redemptions	(2)	—	(2)	(2)	—	(2)
Balance as of December 31	$16	$ (6)	$10	$18	$ (6)	$12

Fair Value of Debt

The estimated fair value of RAI's outstanding consolidated debt, including RJR Tobacco debt, in the aggregate, was $18.2 billion and $5.4 billion as of December 31, 2015 and 2014, respectively, with an effective average annual interest rate of approximately 4.6% and 4.5% for the years ended December 31, 2015 and 2014, respectively. The fair values are based on available market quotes, credit spreads and discounted cash flows, as appropriate.

Interest Rate Management

From time to time, RAI and RJR have used interest rate swaps to manage interest rate risk on a portion of their respective debt obligations.

In 2009, RAI and RJR entered into offsetting floating to fixed interest rate swap agreements in the notional amount of $1.5 billion with maturity dates ranging from June 1, 2012 to June 15, 2017. The floating to fixed interest rate swap agreements were entered into with the same financial institution that held a notional amount of $1.5 billion of fixed to floating interest rate swaps.

In September 2011, RAI and RJR terminated the original and offsetting interest rate swap agreements, each with a notional amount of $1.5 billion, and received a total of $186 million in exchange for foregoing the future cash inflows associated with these swaps. These actions did not change the effective fixed rate of interest associated with the underlying debt.

In September 2013, RAI called for the redemption of, among other RAI notes, the $775 million outstanding principal amount of 7.625% notes due in 2016. Approximately $450 million of this outstanding principal amount was included in the interest rate swap agreements described above. A loss of $124 million on the early extinguishment for all redeemed notes, which includes $35 million of the unamortized portion of the interest rate swap agreement associated with the notes due in 2016, was included in other (income) expense, net in the consolidated statements of income for the year ended December 31, 2013. As a result of this action and the maturity of debt in June 2012, RAI had $700 million of previously swapped outstanding fixed rate debt with an effective rate of interest of approximately 3.8%, as of December 31, 2015 and 2014.

In May 2012, RAI entered into forward starting interest rate contracts with an aggregate notional amount of $1 billion. RAI designated those derivatives as cash flow hedges of a future debt issuance, and they were determined to be highly effective at inception. The forward starting interest rate contracts mitigated RAI's exposure to changes in the benchmark interest rate from the date of inception until the date of the forecasted transaction. On October 31, 2012, RAI completed the sale of $2.55 billion in aggregate principal amount of senior notes, consisting of $450 million of 1.05% senior notes due October 30, 2015, $1.1 billion of 3.25% senior notes due November 1, 2022 and $1 billion of 4.75% senior notes due November 1, 2042. The forward starting interest rate contracts were terminated, and $23 million in associated losses were settled with cash payments to the counterparties. The effective portion of the losses are recorded in accumulated other comprehensive loss in the consolidated balance sheets as of December 31, 2015 and 2014, and will be amortized over the life of the related debt. An insignificant portion of the loss was deemed to be ineffective and recorded in the consolidated statements of income for the year ended December 31, 2012.

The amortization of derivative instruments impacted the consolidated statements of income for the years ended December 31 as follows:

	2015	2014	2013
Interest and debt expense	$(17)	$(15)	$(24)
Other (income) expense, net	—	—	(35)

On June 12, 2015, RJR Tobacco assumed the fixed to floating interest rate swap agreements that Lorillard Tobacco held on its 8.125% notes due in 2019. Under the agreement, RJR Tobacco receives interest based on a fixed rate of 8.125% and pays interest based on a floating one-month LIBOR rate plus a spread of 4.625%. The variable rate was 5.045% as of December 31, 2015. The agreements expire in June 2019. The interest rate swap agreements qualify for hedge accounting and were designated as fair value hedges at the date of the Merger. Under the swap agreements, RJR Tobacco receives a fixed rate settlement and pays a variable rate settlement with the difference recorded in interest expense. The difference reduced interest expense by $13 million for the year ended December 31, 2015. As of December 31, 2015, the fair value hedges were highly effective, with an immaterial gain representing the ineffective portion, which was recorded in other (income) expense, net in the consolidated statements of income for the year ended December 31, 2015. See note 12 for additional information relating to fair value hedges.

Note 4 — Intangible Assets

The changes in the carrying amounts of goodwill by segment were as follows:

	RJR Tobacco	Santa Fe	American Snuff	All Other	Consolidated
Balance as of December 31, 2013					
Goodwill	$ 9,065	$197	$2,501	$ 39	$11,802
Less: accumulated impairment charges	(3,763)	—	(28)	—	(3,791)
Net goodwill balance as of December 31, 2013	5,302	197	2,473	39	8,011
2014 Activity					
Asset acquisition	—	—	—	7	7
Foreign currency translation	—	—	—	(2)	(2)
Balance as of December 31, 2014					
Goodwill	9,065	197	2,501	44	11,807
Less: accumulated impairment charges	(3,763)	—	(28)	—	(3,791)
Net goodwill balance as of December 31, 2014	5,302	197	2,473	44	8,016
2015 Activity					
Merger goodwill	9,853	—	—	—	9,853
Divestiture goodwill	(1,849)	—	—	—	(1,849)
Reclassified to assets held for sale	—	—	—	(27)	(27)
Balance as of December 31, 2015					
Goodwill	17,069	197	2,501	17	19,784
Less: accumulated impairment charges	(3,763)	—	(28)	—	(3,791)
Net goodwill balance as of December 31, 2015	$13,306	$197	$2,473	$ 17	$15,993

The changes in the carrying amounts of indefinite-lived intangible assets by segment not subject to amortization were as follows:

	RJR Tobacco		Santa Fe	American Snuff	All Other	Consolidated	
	Trademarks	Other	Trademarks	Trademarks	Other	Trademarks	Other
Balance as of December 31, 2012	$ 1,027	$ 99	$155	$1,136	$ 5	$ 2,318	$104
Impairment charge	(32)	—	—	—	—	(32)	—
Foreign currency translation	—	—	—	—	(1)	—	(1)
Reclassified to finite-lived	(18)	—	—	—	—	(18)	—
Balance as of December 31, 2013	977	99	155	1,136	4	2,268	103
Balance as of December 31, 2014	977	99	155	1,136	4	2,268	103
Trademarks acquired in Merger	27,193	—	—	—	—	27,193	—
Trademarks divested	(344)	—	—	—	—	(344)	—
Other intangibles divested	—	(12)	—	—	—	—	(12)
Reclassified to assets held for sale	—	—	(19)	—	(4)	(19)	(4)
Balance as of December 31, 2015	$27,826	$ 87	$136	$1,136	$—	$29,098	$ 87

The changes in the carrying amounts of finite-lived intangible assets by segment subject to amortization were as follows:

	RJR Tobacco		American Snuff	Consolidated	
	Trademarks	Other	Trademarks	Trademarks	Other
Balance as of December 31, 2012	$—	$ 24	$ 9	$ 9	$ 24
Amortization	—	(4)	(1)	(1)	(4)
Reclassified from indefinite-lived	18	—	—	18	—
Balance as of December 31, 2013	18	20	8	26	20
Amortization	(6)	(4)	(1)	(7)	(4)
Acquisition	—	15	—	—	15
Balance as of December 31, 2014	12	31	7	19	31
Trademarks acquired in Merger	10	—	—	10	—
Customer lists acquired in Merger	—	240	—	—	240
Amortization	(5)	(12)	(1)	(6)	(12)
Balance as of December 31, 2015	$17	$259	$ 6	$23	$259

Acquisition-related intangible assets include finite-lived trademarks and acquired customer lists, which are being amortized using the straight-line method over their estimated useful lives, of 5 and 20 years, respectively. In addition, the acquisition-related intangible assets include an indefinite-lived trademark, which is not amortized. Acquisition-related intangible assets are included in the RJR Tobacco segment. Amortization of these for the year ended December 31, 2015, was $8 million.

As part of the Divestiture, RJR Tobacco divested to Imperial Sub the rights to sell WINSTON and SALEM in U.S. overseas military and U.S. duty-free markets.

On January 13, 2016, RAI, through the Sellers, completed the sale of the international rights to the NATURAL AMERICAN SPIRIT brand name and associated trademarks, along with the international companies that distribute and market the brand outside the United States, to JTI Holding. In accordance with accounting guidance, the intangible assets of the disposal group were reclassified as assets held for sale, which are included in other current assets, in the consolidated balance sheet at December 31, 2015. For further information related to the transaction, see note 22.

Details of finite-lived intangible assets were as follows:

	December 31, 2015			December 31, 2014		
	Gross	Accumulated Amortization	Net	Gross	Accumulated Amortization	Net
Customer lists	$240	$ (7)	$233	$ —	$ —	$—
Contract manufacturing agreements	151	(139)	12	151	(135)	16
Trademarks	124	(101)	23	114	(95)	19
Other intangibles	15	(1)	14	15	—	15
	$530	$(248)	$282	$280	$(230)	$50

The remaining amortization expense associated with finite-lived intangible assets is expected to be as follows:

Year	Amount
2016	$ 23
2017	23
2018	22
2019	16
2020	15
Thereafter	183
	$282

The impairment testing of trademarks in the fourth quarters of 2015, 2014 and 2013 assumed a rate of decline in projected net sales of certain brands, comparable with that assumed in RAI's strategic plan. The fair value of trademarks used in impairment testing was determined by an income approach using a discounted cash flow valuation model under a relief from royalty methodology. The relief-from-royalty model includes the

estimates of the royalty rate that a market participant might assume, projected revenues and judgment regarding the discount rate applied to those estimated cash flows, with that discount rate being 10.0% during 2015, 2014 and 2013. The determination of the discount rate was based on a cost of equity model, using a risk-free rate, adjusted by a stock beta-adjusted risk premium and a size premium.

As a result of these analyses, an impairment charge is recognized if the carrying value of a trademark exceeds its estimated fair value. No impairment charges were indicated for 2015 and 2014. During 2013, impairment was indicated on four of RJR Tobacco's brands, and one trademark brand was reclassified from indefinite-lived to finite-lived. These impairment charges were reflected as decreases in the carrying value of the trademarks in the consolidated balance sheet as of December 31, 2013, as trademark and other intangible asset impairment charges in the consolidated statements of income for the year ended December 31, 2013, and had no impact on cash flows. Certain brands are being amortized over their remaining useful lives, which range from 3 to 7 years, consistent with the pattern of economic benefits estimated to be received.

For the annual impairment testing of the goodwill of RAI's reporting units, each reporting unit's estimated fair value was compared with its carrying value. A reporting unit is an operating segment or one level below an operating segment. The determination of estimated fair value of each reporting unit was calculated primarily utilizing an income approach model, based on the present value of the estimated future cash flows of the reporting unit assuming a discount rate during each of 2015, 2014 and 2013 of 9.75% for each of RJR Tobacco and American Snuff and 10.25% for Santa Fe. The determination of the discount rate was based on a weighted average cost of capital. Additionally, the aggregate estimated fair value of the reporting units, determined with the use of the income approach model, was compared with RAI's market capitalization. The estimated fair value of each reporting unit was substantially greater than its respective carrying value.

Note 5 — Asset Impairment and Exit Charges

On September 30, 2015, RAI announced that certain of its operating companies consolidated manufacturing operations for the VUSE Digital Vapor Cigarette, which should generate manufacturing and cost efficiencies. In addition to in-house production at RJR Tobacco's manufacturing facility in Tobaccoville, North Carolina, certain production of VUSE cartridges was previously performed for RJR Vapor at a contractor's facility in Kansas. Effective September 30, 2015, all production of VUSE cartridges occurs at the Tobaccoville facility, pursuant to a services agreement between RJR Tobacco and RJR Vapor. As a result of this consolidation, pre-tax asset impairment and exit charges of $99 million, consisting primarily of equipment, were recorded in the consolidated statements of income for the year ended December 31, 2015, and were allocated to All Other.

Note 6 — Restructuring Charges

In 2012, RAI announced that it and its subsidiaries, RJR Tobacco and RAI Services Company, referred to as RAISC, had completed a business analysis designed to identify resources to reinvest in their businesses. As a result of this initiative, the total U.S. workforce of RAI and its subsidiaries declined by a net of approximately 10% upon the completion of the restructuring by the end of 2015. Cash payments related to the restructuring will be substantially complete by the end of 2016.

Under existing severance plans, $111 million of severance, benefits and related costs and $38 million of pension-related benefits comprised a restructuring charge of $149 million during 2012. Of this charge, $138 million was recorded in the RJR Tobacco segment. As of December 31, 2015, $142 million had been utilized. Accordingly, in the consolidated balance sheet as of December 31, 2015, $6 million was included in other current liabilities and $1 million was included in other noncurrent liabilities.

The components of the restructuring charge accrued and utilized were as follows:

	Employee Severance and Benefits
Original accrual	$149
Utilized in 2012	(78)
Balance as of December 31, 2012	71
Utilized in 2013	(14)
Balance as of December 31, 2013	57
Utilized in 2014	(17)
Balance as of December 31, 2014	40
Utilized in 2015	(33)
Balance as of December 31, 2015	$ 7

Note 7 — Income Per Share

The components of the calculation of income per share were as follows:

	For the Years Ended December 31,		
	2015	2014	2013
Income from continuing operations	$ 3,253	$ 1,445	$ 1,718
Income from discontinued operations	—	25	—
Net income	$ 3,253	$ 1,470	$ 1,718
Basic weighted average shares, in thousands	1,264,182	1,066,320	1,089,849
Effect of dilutive potential shares:			
Restricted stock units	3,533	3,620	4,050
Diluted weighted average shares, in thousands	1,267,715	1,069,940	1,093,899

Note 8 — Inventories

The major components of inventories at December 31 were as follows:

	2015	2014
Leaf tobacco	$1,495	$1,125
Other raw materials	110	90
Work in process	88	72
Finished products	173	171
Other	22	27
Total	1,888	1,485
LIFO allowance	(154)	(204)
	$1,734	$1,281

Inventories valued under the LIFO method were $922 million and $456 million at December 31, 2015 and 2014, respectively, net of the LIFO allowance. The LIFO allowance reflects the excess of the current cost of LIFO inventories at December 31, 2015 and 2014, over the amount at which these inventories were carried on the consolidated balance sheets. RAI recognized income of $50 million and $2 million from LIFO inventory changes during 2015 and 2014, respectively, and expense of $14 million from LIFO inventory changes during 2013.

Note 9 — Other Current Liabilities

Other current liabilities at December 31 included the following:

	2015	2014
Payroll and employee benefits	$ 210	$178
Pension and other postretirement benefits	91	75
Marketing and advertising	213	134
Excise, franchise and property tax	217	161
Restructuring	6	32
Other	497	164
	$1,234	$744

Note 10 — Income Taxes

The components of the provision for income taxes from continuing operations for the years ended December 31 were as follows:

	2015	2014	2013
Current:			
Federal	$3,313	$ 809	$ 563
State and other	477	188	148
	3,790	997	711
Deferred:			
Federal	(597)	(151)	254
State and other	(62)	(29)	58
	(659)	(180)	312
	$3,131	$ 817	$1,023

Significant components of deferred tax assets and liabilities for the years ended December 31 included the following:

	2015	2014
Deferred tax assets:		
Pension and other postretirement liabilities	$ 916	$ 823
Tobacco settlement accruals	1,088	711
Other accrued liabilities	175	127
Other noncurrent liabilities	283	139
Subtotal	2,462	1,800
Less: valuation allowance	(8)	(37)
	2,454	1,763
Deferred tax liabilities:		
LIFO inventories	(266)	(150)
Property and equipment	(259)	(260)
Trademarks and other intangibles	(11,002)	(913)
Other	(131)	(111)
	(11,658)	(1,434)
Net deferred tax asset (liability)	$ (9,204)	$ 329

The current and noncurrent components of deferred tax assets and liabilities for the years ended December 31 were as follows:

	2015	2014
Current deferred tax assets	$ 1,032	$ 703
Noncurrent deferred tax assets	—	9
Noncurrent deferred tax liabilities	(10,236)	(383)
	$ (9,204)	$ 329

RAI had no federal capital loss carryforwards at December 31, 2015, compared to $108 million at December 31, 2014. The decrease in 2015 resulted from the utilization of federal capital loss carryforwards related to the Divestiture.

In 2011, a $33 million valuation allowance was established to fully offset a deferred tax asset related to the federal capital loss carryforward. In 2014 and 2013, the valuation allowance was increased by $1 million and $3 million, respectively to $37 million at December 31, 2014, to fully offset a deferred tax asset related to capital losses resulting from the termination of investments. In 2015, the valuation allowance was decreased by $37 million related to the utilization of the federal capital loss carryforwards and increased by $8 million to fully offset the deferred tax assets related to RAI's Puerto Rico subsidiaries. RAI believes it is unlikely that the deferred tax assets attributable to its Puerto Rico subsidiaries will be realized through the expected generation of future taxable income. No valuation allowance was established on other deferred tax assets at December 31, 2015 and 2014, as RAI believes it is more likely than not that all of such deferred tax assets will be realized through the generation of future taxable income.

Pre-tax income for domestic and foreign continuing operations for the years ended December 31 consisted of the following:

	2015	2014	2013
Domestic (includes U.S. exports)	$6,342	$2,235	$2,737
Foreign	42	27	4
	$6,384	$2,262	$2,741

The differences between the provision for income taxes from continuing operations and income taxes computed at statutory U.S. federal income tax rates for the years ended December 31 were as follows:

	2015	2014	2013
Income taxes computed at the statutory U.S. federal income tax rate	$2,233	$ 792	$ 959
State and local income taxes, net of federal tax benefits	235	107	135
Domestic manufacturing deduction	(104)	(80)	(55)
Nondeductible goodwill	761	—	—
Other items, net	6	(2)	(16)
Provision for income taxes from continuing operations	$3,131	$ 817	$1,023
Effective tax rate	49.0%	36.1%	37.3%

The effective tax rate for 2015 was unfavorably impacted by an increase in tax attributable to nondeductible acquisition costs, nondeductible goodwill in the amount of $1,849 million associated with the Divestiture and an increase in uncertain tax positions, offset by a decrease in tax attributable to the release of a valuation allowance in the amount of $37 million and a reduction in state income taxes. The effective tax rate for 2014 was favorably impacted by a decrease in uncertain tax positions related to a federal audit settlement and an increase in the domestic manufacturing deduction, partially offset by an increase in tax attributable to nondeductible acquisition costs. The effective tax rate for 2013 was unfavorably impacted by an increase in tax attributable to a decrease in the domestic manufacturing deduction. The effective tax rate for each period differed from the federal statutory rate of 35% due to the domestic manufacturing deduction, state income taxes and certain nondeductible items.

The audit of the 2010 and 2011 tax years by the Internal Revenue Service was closed in 2014. A tax benefit of $25 million attributable to a decrease in uncertain tax positions was recorded in discontinued operations.

On December 19, 2014, the Tax Increase Prevention Act of 2014, referred to as the TIPA, was signed into law. The TIPA retroactively reinstated and extended the Federal Research and Development Tax Credit from January 1, 2014 to December 31, 2014. The impact of the TIPA did not significantly impact RAI's annual effective income tax rate in 2014.

On December 18, 2015, the Protecting Americans from Tax Hikes (PATH) Act, was signed into law. The PATH Act extends the research credit permanently, retroactive to January 1, 2015. The PATH Act did not significantly impact RAI's annual effective income tax rate in 2015.

At December 31, 2015, there were $515 million of accumulated and undistributed foreign earnings. Of this amount, RAI has invested $26 million and has plans to invest an additional $56 million overseas. RAI has recorded either current or deferred income taxes related to the $433 million of accumulated foreign earnings in excess of its historical and planned overseas investments.

The components of deferred tax benefits included in accumulated other comprehensive loss for the years ended December 31 were as follows:

	2015	2014
Retirement benefits	$209	$241
Unrealized gain (loss) on long-term investments	10	10
Amortization of realized loss on hedging instruments	6	7
Cumulative translation adjustment and other	31	19
	$256	$277

The accruals for gross unrecognized income tax benefits, including interest and penalties, reflected in other noncurrent liabilities for the years ended December 31 were as follows:

	2015	2014
Unrecognized tax benefits	$ 97	$27
Accrued interest	17	3
Accrued penalties	8	1
	$122	$31

A reconciliation of the gross unrecognized income tax benefits is as follows:

	2015	2014	2013
Balance at beginning of year	$27	$ 62	$68
Gross increases related to current period tax positions	28	5	4
Gross increases related to tax positions in prior periods	46	—	—
Gross decreases related to tax positions in prior periods	(1)	(31)	(3)
Gross decreases related to audit settlements	—	(6)	(1)
Gross decreases related to lapse of applicable statute of limitations	(3)	(3)	(6)
Balance at end of year	$97	$ 27	$62

At December 31, 2015, $81 million of unrecognized income tax benefits including interest and penalties, if recognized, would decrease RAI's effective tax rate.

For the year ended December 31, 2015, the gross increases in unrecognized income tax benefits related to tax positions in prior periods are primarily attributable to the Merger.

RAI and its subsidiaries are subject to income taxes in the United States, certain foreign jurisdictions and multiple state jurisdictions. A number of years may elapse before a particular matter, for which RAI has established an accrual, is audited and finally resolved. The number of years with open tax audits varies depending on the tax jurisdiction.

RAI and its subsidiaries file income tax returns in the U.S. federal and various state and foreign jurisdictions. The U.S. federal statute of limitations remains open for the year 2012 and forward. State and foreign jurisdictions have statutes of limitations generally ranging from three to five years. Certain of RAI's state tax returns are currently under examination by various states as part of routine audits conducted in the ordinary course of business.

Note 11 — Borrowing Arrangements

Credit Agreement

In December 2014, RAI entered into a credit agreement, referred to as the Credit Agreement, with a syndicate of lenders, providing for a five-year, $2 billion senior unsecured revolving credit facility, which may be increased to $2.35 billion at the discretion of the lenders upon the request of RAI. The Credit Agreement replaced RAI's four-year, $1.35 billion senior unsecured revolving credit facility dated October 8, 2013.

Subject to certain conditions, RAI is able to use the revolving credit facility under the Credit Agreement for borrowings and issuances of letters of credit at its option, subject to a $300 million sublimit on the aggregate amount of letters of credit. Issuances of letters of credit reduce availability under such revolving credit facility.

The Credit Agreement contains restrictive covenants that, among other things:

- limit the ability of RAI and its subsidiaries to (1) pay dividends and repurchase stock, (2) engage in transactions with affiliates, (3) create liens and (4) engage in sale-leaseback transactions involving a Principal Property, as defined in the Credit Agreement;
- limit the ability of RAI and its Material Subsidiaries, as defined in the Credit Agreement, to sell or dispose of all or substantially all of their assets and engage in specified mergers or consolidations; and
- limit the amount of debt that may be incurred by non-guarantor subsidiaries.

The Credit Agreement contains two financial covenants — a consolidated leverage ratio covenant and a consolidated interest coverage ratio covenant. Under the Credit Agreement, the consolidated leverage ratio may not exceed:

- 3.00 to 1.00 as of the last day of any period of four consecutive fiscal quarters, referred to as a Reference Period, ending prior to the closing of the Merger;
- 4.50 to 1.00 for the Reference Periods ending on the last day of the fiscal quarter in which the Merger closed and on the last day of the next two succeeding fiscal quarters;
- 4.25 to 1.00 for the Reference Periods ending on the last day of the next three succeeding quarters;
- 3.75 to 1.00 for the Reference Periods ending on the last day of the next three succeeding quarters; and
- 3.50 to 1.00 thereafter.

The Credit Agreement provides that the consolidated interest coverage ratio for any Reference Period ending on the last day of a fiscal quarter may not be less than 4.00 to 1.00.

The original maturity date of the Credit Agreement was December 18, 2019. Pursuant to the maturity date extension provision of the Credit Agreement, the requisite lenders agreed, in October 2015 and upon RAI's request, to extend the maturity date of the Credit Agreement by 12 months, to December 18, 2020. In connection with such extension, (1) a portion ($35 million) of one lender's commitment under the Credit Agreement was reduced, and reallocated among certain other lenders party to the Credit Agreement, and (2) the aggregate letter of credit commitments under the Credit Agreement were reduced from $200 million to $100 million. Subject to the terms and conditions stated therein, the maturity date of the Credit Agreement may be extended further, upon the request of RAI and with the consent of the requisite lenders, an additional 12 months to December 18, 2021. The Credit Agreement contains customary events of default, including upon a change in control (as defined therein), which could result in the acceleration of all amounts and cancellation of all commitments outstanding under the Credit Agreement.

The lenders' obligations under the Credit Agreement to fund borrowings are subject to the accuracy of RAI's representations and warranties and the absence of any default, provided, however, that the accuracy of RAI's representation as to the absence of any material adverse effect (as defined in the Credit Agreement) is not a condition to borrowing for the purpose of refinancing maturing commercial paper.

Under the terms of the Credit Agreement, RAI is required to pay a facility fee of between 0.100% and 0.275%, based generally on the ratings of RAI's senior, unsecured, long-term indebtedness, per annum on the lender commitments in respect of the revolving credit facility thereunder.

Borrowings under the Credit Agreement bear interest, at the option of RAI, at a rate equal to an applicable margin based generally on the ratings of RAI's senior, unsecured, long-term indebtedness, plus:

- the alternate base rate, which is the higher of (1) the federal funds effective rate from time to time plus 0.5%, (2) the prime rate and (3) the reserve adjusted eurodollar rate for a one month interest period plus 1%; or
- the eurodollar rate, which is the reserve adjusted rate at which eurodollar deposits for one, two, three or six months are offered in the interbank eurodollar market.

Overdue principal outstanding under the revolving credit facility under the Credit Agreement bears interest at a rate equal to the rate then in effect with respect to such borrowings, plus 2.0% per annum. Any amount besides principal that becomes overdue bears interest at a rate equal to 2.0% per annum in excess of the rate of interest applicable to base rate loans.

Certain of RAI's subsidiaries, including its Material Subsidiaries, have guaranteed, on an unsecured basis, RAI's obligations under the Credit Agreement. Under the Credit Agreement, any new Material Subsidiary of RAI must be added as a guarantor of the Credit Agreement. On August 31, 2015, Lorillard Licensing Company LLC (which became an indirect wholly owned subsidiary of RAI as a result of the Merger), referred to as Lorillard Licensing, entered into a Joinder Agreement to the Subsidiary Guarantee for the purpose of adding Lorillard Licensing as a guarantor under the Credit Agreement.

In 2015, RAI borrowed and repaid $1.4 billion under the Credit Agreement at an average interest rate of 1.37%. As of December 31, 2015, there were no outstanding borrowings and $8 million of letters of credit outstanding under the Credit Agreement.

Bridge Facility

In September 2014, RAI entered into a bridge credit agreement, referred to as the Bridge Facility, with a syndicate of lenders, providing for a 364-day senior unsecured term loan in the aggregate principal amount of up to $9 billion. The Bridge Facility was available for the purpose of financing a portion of the Merger Consideration. As described below in note 12, RAI issued notes, in lieu of borrowing any funds under the Bridge Facility, to finance part of the cash portion of the Merger Consideration. By its terms, the Bridge Facility terminated on June 12, 2015. All associated fees were fully amortized by June 30, 2015. Amortization and fees related to the Bridge Facility were $48 million and $39 million for the years ended December 31, 2015 and 2014, respectively, and were included in interest and debt expense.

Note 12 — Long-Term Debt

New Notes

On June 12, 2015, RAI completed an underwritten public offering of $9.0 billion aggregate principal amount of its senior notes, consisting of $1.25 billion aggregate principal amount of 2.30% Senior Notes due 2018, $1.25 billion aggregate principal amount of 3.25% Senior Notes due 2020, $1.0 billion aggregate principal amount of 4.00% Senior Notes due 2022, $2.5 billion aggregate principal amount of 4.45% Senior Notes due 2025, $750 million aggregate principal amount of 5.70% Senior Notes due 2035 and $2.25 billion aggregate principal amount of 5.85% Senior Notes due 2045. The foregoing RAI notes are collectively referred to as the New Notes. The proceeds from the offering of the New Notes were used to fund part of the cash portion of the Merger Consideration, the unpaid fees and expenses incurred in connection with the Merger and related transactions contemplated by the Merger Agreement, and the payment of certain Lorillard equity awards and certain change of control payments, also as contemplated by the Merger Agreement.

The New Notes are unsecured, and are fully and unconditionally guaranteed on a senior unsecured basis by certain of RAI's subsidiaries, including its material domestic subsidiaries, which are the same guarantors that guarantee its other outstanding senior notes and its Credit Agreement. The indenture, referred to as the 2006 indenture, under which RAI's outstanding notes, including the New Notes, which was issued requires that a new guarantor of the Credit Agreement be added as a guarantor of the 2006 indenture and the debt securities issued thereunder. As a result, effective September 2, 2015, Lorillard Licensing entered into a supplemental indenture to the 2006 indenture for the purpose of adding Lorillard Licensing as a guarantor of the 2006 indenture and the debt securities issued thereunder. Any guarantor that is released from its guarantee under the Credit Agreement, or any replacement or refinancing thereof, also will be released automatically from its guarantee of the New Notes and RAI's other outstanding notes. RAI may redeem the New Notes in whole or in part at any time at the applicable redemption price. If RAI experiences specific kinds of changes of control, accompanied by a certain credit ratings downgrade of any series of New Notes, RAI must offer to repurchase such series.

Lorillard Tobacco Notes

Immediately prior to the Merger, Lorillard Tobacco had outstanding an aggregate of $3.5 billion in principal amount of senior unsecured notes in seven series, referred to as the Lorillard Tobacco Notes, all of which were guaranteed by Lorillard. In connection with the Lorillard Tobacco Merger, RJR Tobacco assumed Lorillard Tobacco's obligations under the Lorillard Tobacco Notes and the indenture governing the Lorillard Tobacco Notes, referred to as the Lorillard Tobacco Indenture, and RJR assumed Lorillard's obligations as guarantor under the Lorillard Tobacco Notes and the Lorillard Tobacco Indenture.

Exchange Offers and Consent Solicitations

On June 11, 2015, RAI commenced (1) private offers to exchange, referred to as the Exchange Offers, any and all (to the extent held by eligible holders) of the Lorillard Tobacco Notes for a series of new RAI senior notes, referred to as the Exchange Notes, having the same interest payment and maturity dates and interest rate provisions as the corresponding series of Lorillard Tobacco Notes, and (2) related consent solicitations, referred to as the Consent Solicitations, of the eligible holders of each series of Lorillard Tobacco Notes to amend the Lorillard Tobacco Indenture, with such amendments referred to as the Indenture Amendments.

The Exchange Offers and Consent Solicitations expired on July 10, 2015, referred to as the Expiration Date. Eligible holders who validly tendered, and did not validly withdraw, their Lorillard Tobacco Notes in the Exchange Offers (and thereby gave, and did not validly revoke, their consents to the Indenture Amendments) received, upon settlement of the Exchange Offers and Consent Solicitations on July 15, 2015, Exchange Notes in

the same principal amount as the Lorillard Tobacco Notes tendered therefor plus a consent payment of $2.50 per $1,000 principal amount of Lorillard Tobacco Notes tendered. The following table sets forth, as of the Expiration Date, the principal amounts of each series of Lorillard Tobacco Notes that (1) had been validly tendered and not validly withdrawn (and consents thereby validly given and not validly revoked) and (2) were not tendered in the Exchange Offers:

Series of Lorillard Tobacco Notes	Principal Amount of Lorillard Tobacco Notes Outstanding Prior to Exchange Offers	Principal Amount of Lorillard Tobacco Notes Tendered in Exchange Offers	Principal Amount of Lorillard Tobacco Notes Not Tendered in Exchange Offers
2.300% notes due 2017	$ 500	$ 447	$ 53
3.500% notes due 2016	500	415	85
3.750% notes due 2023	500	474	26
6.875% notes due 2020	750	641	109
7.000% notes due 2041	250	240	10
8.125% notes due 2019	750	669	81
8.125% notes due 2040	250	237	13
	$3,500	$3,123	$377

RJR Tobacco remains the principal obligor of the Lorillard Tobacco Notes that were not tendered in the Exchange Offers, and currently RAI and RJR are the guarantors of such notes. The Exchange Notes are the principal obligations of RAI and are guaranteed by the same guarantors as RAI's other outstanding senior notes, including the New Notes. Unlike RAI's outstanding senior notes, including the New Notes and Exchange Notes, the Lorillard Tobacco Notes (with a limited exception for the 3.75% Lorillard Tobacco Notes due 2023) are not redeemable at the option of the issuer prior to maturity.

The Exchange Notes were issued in a private offering exempt from, or not subject to, the registration requirements of the federal securities laws. RAI entered into a registration rights agreement, however, upon the settlement of the Exchange Offers, pursuant to which RAI agreed, among other things, to offer to exchange the Exchange Notes for materially identical notes registered under the Securities Act of 1933, referred to as the 1933 Act. In order to satisfy its obligations under such registration rights agreement, on November 18, 2015, RAI commenced registered offers to exchange any and all (to the extent held by eligible holders) of the Exchange Notes for its newly issued notes registered under the 1933 Act, referred to as the Registered Notes. On December 23, 2015, RAI completed the foregoing registered exchange offers and, of the total aggregate principal amount of Exchange Notes outstanding, 99.7% were exchanged for Registered Notes. Each series of Registered Notes is substantially identical to the Exchange Notes of the corresponding series, except that the Registered Notes are registered under the 1933 Act and do not bear any legends restricting transfer, and except that the registration rights and certain additional interest provisions pertaining to the Exchange Notes do not apply to the Registered Notes. The Registered Notes are unsecured, and are fully and unconditionally guaranteed on a senior unsecured basis by the same RAI subsidiaries that guarantee RAI's other outstanding senior notes and its Credit Agreement. Any guarantor that is released from its guarantee under the Credit Agreement, or any replacement or refinancing thereof, also will be released automatically from its guarantee of the Registered Notes and RAI's other outstanding notes. RAI may redeem the Registered Notes, in whole or in part, at any time at the applicable redemption price. If RAI experiences specific kinds of change of control, accompanied by a certain credit rating downgrade of any series of Registered Notes, RAI must offer to repurchase such series.

In addition, in connection with the Consent Solicitations, RAI received the requisite number of consents to adopt the Indenture Amendments, which became operative on the July 15, 2015, settlement date, with respect to each of the seven series of Lorillard Tobacco Notes. The Indenture Amendments:

- eliminated substantially all of the restrictive covenants and a bankruptcy event of default for the issuer and the guarantor of the Lorillard Tobacco Notes under the Lorillard Tobacco Indenture;
- eliminated the requirement under the Lorillard Tobacco Indenture that the guarantor of the Lorillard Tobacco Notes continue to provide holders of the Lorillard Tobacco Notes with financial statements and other financial information similar to that provided in periodic reports under the Securities Exchange Act of 1934 when it is not subject to such reporting requirements; and
- relieved the issuer of the Lorillard Tobacco Notes of the requirement (if any) under the Lorillard Tobacco Indenture that the issuer offer to repurchase the Lorillard Tobacco Notes upon certain change of control events combined with certain credit ratings events to the extent such change of control events relate to, arise out of or are undertaken in connection with the Merger or the Lorillard Tobacco Merger.

RAI and RJR Tobacco Total Long-Term Debt

RAI's long-term debt, net of discounts and including adjustments associated with interest rate swaps of $25 million and $48 million as of December 31, 2015, and December 31, 2014, respectively, and adjustments to fair value of $323 million as of December 31, 2015, is below. RJR Tobacco's long-term debt, including adjustments to fair value of $36 million as of December 31, 2015, is below.

	2015	2014
RAI		
2.300% notes due 2017	$ 450	$ —
2.300% notes due 2018	1,250	—
3.250% notes due 2020	1,250	—
3.250% notes due 2022	1,099	1,099
3.750% notes due 2023	461	—
4.000% notes due 2022	999	—
4.450% notes due 2025	2,493	—
4.750% notes due 2042	992	992
4.850% notes due 2023	549	550
5.700% notes due 2035	747	—
5.850% notes due 2045	2,238	—
6.150% notes due 2043	548	547
6.750% notes due 2017	729	747
6.875% notes due 2020	735	—
7.000% notes due 2041	287	—
7.250% notes due 2037	448	448
7.750% notes due 2018	250	250
8.125% notes due 2019 *	781	—
8.125% notes due 2040	308	—
Total RAI long-term debt	$16,614	$4,633
RJR Tobacco		
2.300% notes due 2017	$ 53	$ —
3.750% notes due 2023	26	—
6.875% notes due 2020	124	—
7.000% notes due 2041	12	—
8.125% notes due 2019 *	95	—
8.125% notes due 2040	17	—
Total RJR Tobacco long-term debt	$ 327	$ —
Total long-term debt (less current maturities)	$16,941	$4,633
Current maturities of long-term debt	506	450
	$17,447	$5,083

* The interest rate payable on these notes generally is subject to adjustment from time to time (as detailed in the form of these notes) based upon the credit rating assigned to these notes, provided that in no event will (1) the interest rate for these notes be reduced below 8.125% or (2) the total increase in the interest rate on these notes exceed 2.0% above 8.125%.

As of December 31, 2015, the maturities of RAI's and RJR Tobacco's notes, net of discounts, were as follows:

Year	RAI	RJR Tobacco	Amount
2016	$ 415	$ 85	$ 500
2017	1,147	53	1,200
2018	1,500	—	1,500
2019	669	81	750
2020	1,891	109	2,000
2022 and thereafter	11,064	49	11,113
	$16,686	$377	$17,063

In September 2013, RAI completed the sale of $1.1 billion in aggregate principal amount of senior notes, consisting of $550 million 4.85% notes due September 15, 2023, and $550 million 6.15% notes due September 15, 2043. Interest on these notes is paid semi-annually.

In September 2013, RAI called for the redemption of the $200 million outstanding principal amount of its 7.30% notes due in 2015, and the $775 million outstanding principal amount of its 7.625% notes due in 2016. A loss of $124 million on the early extinguishment, which includes $35 million of the unamortized portion of the interest rate swap agreements associated with the 7.625% notes, was included in other (income) expense, net in the consolidated statements of income for the year ended December 31, 2013.

On June 12, 2015, RJR Tobacco assumed the interest rate swap agreements associated with the 8.125% Lorillard Tobacco Notes due in 2019. The interest rate swap agreements qualify for hedge accounting and were designated as fair value hedges at the date of the Merger. Under the swap agreements, RJR Tobacco receives a fixed rate settlement and pays a variable rate settlement with the difference recorded in interest expense.

For derivatives designated as fair value hedges, which relate entirely to hedges of long-term debt, changes in the fair value of the derivatives are recorded in other assets or other liabilities with an offsetting adjustment to the carrying amount of the hedged debt. Any temporary differences in the change in the fair value of the derivatives relative to the change in the fair value of the hedged debt are recorded in other (income) expense, net. At December 31, 2015, the adjusted carrying amount of the hedged debt was $876 million. The fair value hedge included in other assets and deferred charges in the consolidated balance sheet was $53 million.

See note 2 for additional information on the Merger, note 3 for additional information on interest rate management and note 22 for subsequent events.

Note 13 — Commitments and Contingencies

Tobacco Litigation — General

Introduction

Various legal proceedings or claims, including litigation claiming that cancer and other diseases, as well as addiction, have resulted from the use of, or exposure to, RAI's operating subsidiaries' products, are pending or may be instituted against RJR Tobacco (including as successor by merger to Lorillard Tobacco, as detailed below), American Snuff Co., SFNTC, or RJR Vapor or their affiliates, including RAI, RJR, Lorillard or indemnitees, including B&W, sometimes collectively referred to as Reynolds Defendants. These pending legal proceedings include claims relating to cigarette products (and e-cigarettes) manufactured by RJR Tobacco, Lorillard Tobacco or certain of their affiliates or indemnitees, as well as claims relating to smokeless tobacco products manufactured by American Snuff Co. A discussion of the legal proceedings relating to cigarette products (and e-cigarettes) is set forth below under the heading "— Litigation Affecting the Cigarette Industry." All of the references under that heading to tobacco-related litigation, smoking and health litigation and other similar references are references to legal proceedings relating to cigarette products or e-cigarettes, as the case may be, and are not references to legal proceedings involving smokeless tobacco products, and case numbers under that heading include only cases involving cigarette products and e-cigarettes. The legal proceedings relating to the smokeless tobacco products manufactured by American Snuff Co. are discussed separately under the heading "— Smokeless Tobacco Litigation" below.

In connection with the B&W business combination, RJR Tobacco has agreed to indemnify B&W and its affiliates, including its indirect parent, BAT, against certain liabilities, costs and expenses incurred by B&W or its affiliates arising out of the U.S. cigarette and tobacco business of B&W. As a result of this indemnity, RJR Tobacco has assumed the defense of pending B&W-specific tobacco-related litigation, has paid the judgments and costs related to certain pre-business combination tobacco-related litigation of B&W, and has posted bonds on behalf of B&W, where necessary, in connection with cases decided since the B&W business combination. In connection with the Merger and Divestiture, as applicable, RAI and RJR Tobacco undertook certain indemnification obligations. See "— Other Contingencies — Imperial Sub Indemnity" and "— Other Contingencies — Loews Indemnity" below. In addition, in connection with the sale of the non-U.S. operations and business of the NATURAL AMERICAN SPIRIT brand, the Sellers have agreed to indemnify the buyer for certain claims. See "— Other Contingencies — JTI Indemnities" below.

On June 12, 2015, Lorillard Tobacco was merged with and into RJR Tobacco, with RJR Tobacco as the surviving entity and Lorillard Tobacco ceasing to exist. As a consequence of the Lorillard Tobacco Merger, RJR Tobacco succeeded to Lorillard Tobacco's liabilities, and RJR Tobacco assumed the defense of pending Lorillard

Tobacco litigation and is responsible for paying judgments, paying costs, and posting bonds relating to Lorillard Tobacco's litigation. Although Lorillard Tobacco no longer exists as a result of the Lorillard Tobacco Merger, it will remain as a named party in cases pending on the date of the Lorillard Tobacco Merger until courts grant motions to substitute RJR Tobacco for Lorillard Tobacco or the claims are dismissed.

Certain Terms and Phrases

Certain terms and phrases used in this disclosure may require some explanation. The term "judgment" or "final judgment" refers to the final decision of the court resolving the dispute and determining the rights and obligations of the parties. At the trial court level, for example, a final judgment generally is entered by the court after a jury verdict and after post-verdict motions have been decided. In most cases, the losing party can appeal a verdict only after a final judgment has been entered by the trial court.

The term "damages" refers to the amount of money sought by a plaintiff in a complaint, or awarded to a party by a jury or, in some cases, by a judge. "Compensatory damages" are awarded to compensate the prevailing party for actual losses suffered, if liability is proved. In cases in which there is a finding that a defendant has acted willfully, maliciously or fraudulently, generally based on a higher burden of proof than is required for a finding of liability for compensatory damages, a plaintiff also may be awarded "punitive damages." Although damages may be awarded at the trial court stage, a losing party generally may be protected from paying any damages until all appellate avenues have been exhausted by posting a supersedeas bond. The amount of such a bond is governed by the law of the relevant jurisdiction and generally is set at the amount of damages plus some measure of statutory interest, modified at the discretion of the appropriate court or subject to limits set by court or statute.

The term "per curiam" refers to an opinion entered by a court. In most cases, it is used to indicate that the opinion entered is a brief announcement of the court's decision and is not accompanied by a written opinion.

The term "settlement" refers to certain types of cases in which cigarette manufacturers, including RJR Tobacco, B&W and Lorillard Tobacco, have agreed to resolve disputes with certain plaintiffs without resolving the case through trial. The principal terms of certain settlements entered into by RJR Tobacco, B&W and Lorillard Tobacco are explained below under "— Accounting for Tobacco-Related Litigation Contingencies."

Theories of Recovery

The plaintiffs seek recovery on a variety of legal theories, including negligence, strict liability in tort, design defect, failure to warn, fraud, misrepresentation, violations of unfair and deceptive trade practices statutes, conspiracy, medical monitoring and violations of state and federal antitrust laws. In certain of these cases, the plaintiffs claim that cigarette smoking exacerbated injuries caused by exposure to asbestos or, in the case of certain claims asserted against Lorillard Tobacco, that they were injured by exposure to asbestos-containing filters used in one cigarette brand for roughly four years before 1957, the latter cases referred to as Filter Cases.

The plaintiffs seek various forms of relief, including compensatory and, where available, punitive damages, treble or multiple damages and statutory damages and penalties, creation of medical monitoring and smoking cessation funds, disgorgement of profits, and injunctive and other equitable relief. Although alleged damages often are not determinable from a complaint, and the law governing the pleading and calculation of damages varies from jurisdiction to jurisdiction, compensatory and punitive damages have been specifically pleaded in a number of cases, sometimes in amounts ranging into the hundreds of millions and even billions of dollars.

Defenses

The defenses raised by Reynolds Defendants and their affiliates and indemnitees include, where applicable and otherwise appropriate, preemption by the Federal Cigarette Labeling and Advertising Act of some or all claims arising after 1969, or by the Comprehensive Smokeless Tobacco Health Education Act for claims arising after 1986, the lack of any defect in the product, assumption of the risk, contributory or comparative fault, lack of proximate cause, remoteness, lack of standing, statutes of limitations or repose and others. RAI, RJR and Lorillard have asserted additional defenses, including jurisdictional defenses, in many of the cases in which they are named.

Accounting for Tobacco-Related Litigation Contingencies

In accordance with GAAP, RAI and its subsidiaries record any loss concerning litigation at such time as an unfavorable outcome becomes probable and the amount can be reasonably estimated on an individual

case-by-case basis. For the reasons set forth below, RAI's management continues to conclude that the loss of any particular pending smoking and health tobacco litigation claim against RJR Tobacco, Lorillard Tobacco or their affiliates or indemnitees, or the loss of any particular claim concerning the use of smokeless tobacco products against American Snuff Co., when viewed on an individual basis, is not probable, except for certain *Engle* Progeny cases noted below.

Reynolds Defendants believe that they have valid defenses to the smoking and health tobacco litigation claims against them, as well as valid bases for appeal of adverse verdicts against them. Reynolds Defendants have, through their counsel, filed pleadings and memoranda in pending smoking and health tobacco litigation that set forth and discuss a number of grounds and defenses that they and their counsel believe have a valid basis in law and fact. With the exception of the *Engle* Progeny cases described below, Reynolds Defendants continue to win the majority of smoking and health tobacco litigation claims that reach trial, and a very high percentage of the tobacco-related litigation claims brought against them, including *Engle* Progeny cases, continue to be dismissed at or before trial. Based on their experience in smoking and health tobacco litigation and the strength of the defenses available to them in such litigation, RJR Tobacco and its affiliates believe that their successful defense of smoking and health tobacco litigation in the past will continue in the future.

RAI's consolidated balance sheet as of December 31, 2015, contains accruals for the following *Engle* Progeny cases: *Hiott, Starr-Blundell, Clayton, Ward, Hallgren, Cohen, Sikes, Thibault, Buonomo, Taylor* and *Ballard.* RJR Tobacco paid approximately $4.9 million in satisfaction of the judgment in *Taylor* on January 19, 2016. Other accruals include an amount for the estimated costs of the corrective communications in the *U.S. Department of Justice* case and an amount for the settlement of the *Sateriale* case, discussed below. As other cases proceed through the appellate process, RAI will evaluate the need for further accruals on an individual case-by-case basis if an unfavorable outcome becomes probable and the amount can be reasonably estimated.

It is the policy of RJR Tobacco and its affiliates to defend tobacco-related litigation claims vigorously; generally, RJR Tobacco and its affiliates and indemnitees do not settle such claims. However, RJR Tobacco and its affiliates may enter into settlement discussions in some cases, if they believe it is in their best interests to do so. Exceptions to this general approach include actions taken pursuant to "offer of judgment" statutes, as described below in "— Litigation Affecting the Cigarette Industry — Overview," and Filter Cases, as described below in "— Litigation Affecting the Cigarette Industry — Filter Cases," as well as other historical examples discussed below.

With respect to smoking and health tobacco litigation claims, the only significant settlements reached by RJR Tobacco, Lorillard Tobacco and B&W involved:

- the State Settlement Agreements and the funding by various tobacco companies of a $5.2 billion trust fund contemplated by the MSA to benefit tobacco growers;
- the original *Broin* flight attendant case discussed below under "— Litigation Affecting the Cigarette Industry — *Broin II* Cases," and
- most of the *Engle* Progeny cases pending in federal court, after the initial docket of over 4,000 such cases was reduced to approximately 400 cases.

The circumstances surrounding the State Settlement Agreements and the funding of a trust fund to benefit the tobacco growers are readily distinguishable from the current categories of smoking and health cases involving Reynolds Defendants. The claims underlying the State Settlement Agreements were brought on behalf of the states to recover funds paid for health care and medical and other assistance to state citizens suffering from diseases and conditions allegedly related to tobacco use. The State Settlement Agreements settled all the health-care cost recovery actions brought by, or on behalf of, the settling jurisdictions and contain releases of various additional present and future claims. In accordance with the MSA, various tobacco companies agreed to fund a $5.2 billion trust fund to be used to address the possible adverse economic impact of the MSA on tobacco growers. A discussion of the State Settlement Agreements, and a table depicting the related payment schedule, is set forth below under "— Litigation Affecting the Cigarette Industry — Health-Care Cost Recovery Cases."

The states were a unique set of plaintiffs and are not involved in any of the smoking and health cases remaining against RJR Tobacco, Lorillard Tobacco or their affiliates and indemnitees. Although certain Reynolds Defendants continue to be defendants in health-care cost recovery cases similar in theory to the state cases but involving other plaintiffs, such as Native American tribes and foreign governments, the vast majority of such cases have been dismissed on legal grounds. RJR Tobacco and its affiliates, including RAI, believe that the same legal principles that have resulted in dismissal of health-care cost recovery cases either at the trial court level or on appeal should compel dismissal of the similar pending cases.

As with claims that were resolved by the State Settlement Agreements, the other cases settled by RJR Tobacco can be distinguished from existing cases pending against RJR Tobacco, Lorillard Tobacco and their affiliates and indemnitees. The original *Broin* case, discussed below under "— Litigation Affecting the Cigarette Industry — *Broin II* Cases," was settled in the middle of trial during negotiations concerning a possible nation-wide settlement of claims similar to those underlying the State Settlement Agreements.

The federal *Engle* Progeny cases likewise presented exceptional circumstances not present in the state *Engle* Progeny cases or elsewhere. All of the federal *Engle* Progeny cases subject to the settlement were pending in the same court, coordinated by the same judge, and involved the same sets of plaintiffs' lawyers. Moreover, RJR Tobacco settled only after the docket was reduced by approximately 90%. A discussion of the *Engle* Progeny cases and the settlement of the federal *Engle* Progeny cases is set forth below under "— Litigation Affecting the Cigarette Industry — *Engle* and *Engle* Progeny Cases."

In 2010, RJR Tobacco entered into a comprehensive agreement with the Canadian federal, provincial and territorial governments, which resolved all civil claims related to the movement of contraband tobacco products in Canada during the period 1985 through 1999 that the Canadian governments could assert against RJR Tobacco and its affiliates. These claims were separate from any smoking and health tobacco litigation.

Also, in 2004, RJR Tobacco and B&W separately settled the antitrust case *DeLoach v. Philip Morris Cos., Inc.,* which was brought by a unique class of plaintiffs: a class of all tobacco growers and tobacco allotment holders. The plaintiffs asserted that the defendants conspired to fix the price of tobacco leaf and to destroy the federal government's tobacco quota and price support program. Despite legal defenses they believed to be valid, RJR Tobacco and B&W separately settled this case to avoid a long and contentious trial with the tobacco growers. The *DeLoach* case and an antitrust case previously pending against RJR Tobacco and B&W involved different types of plaintiffs and different theories of recovery under the antitrust laws than the smoking and health cases pending against RJR Tobacco, Lorillard Tobacco and their affiliates and indemnitees.

Finally, as discussed under "— Litigation Affecting the Cigarette Industry — State Settlement Agreements — Enforcement and Validity; Adjustments," RJR Tobacco, B&W and Lorillard Tobacco each has settled certain cases brought by states concerning the enforcement of State Settlement Agreements. Despite legal defenses believed to be valid, these cases were settled to avoid further contentious litigation with the states involved. These enforcement actions involve alleged breaches of State Settlement Agreements based on specific actions taken by particular defendants. Accordingly, any future enforcement actions involving State Settlement Agreements will be reviewed by RJR Tobacco on the merits and should not be affected by the settlement of prior enforcement cases.

American Snuff Co. also believes that it has valid defenses to the smokeless tobacco products litigation against it. American Snuff Co. asserted and will continue to assert some or all of these defenses in each case at the time and in the manner deemed appropriate by American Snuff Co. and its counsel. No verdict or judgment has been returned or entered against American Snuff Co. on any claim for personal injuries allegedly resulting from the use of smokeless tobacco products. American Snuff Co. intends to defend vigorously all smokeless tobacco litigation claims asserted against it. No liability for pending smokeless tobacco litigation was recorded in RAI's consolidated balance sheet as of December 31, 2015.

Cautionary Statement

Even though RAI's management continues to believe that the loss of particular pending smoking and health tobacco litigation claims against Reynolds Defendants, or the loss of any particular case concerning the use of smokeless tobacco against American Snuff Co., when viewed on an individual case-by-case basis, is not probable or estimable (except for certain *Engle* Progeny cases described below), the possibility of material losses related to such litigation is more than remote. Litigation is subject to many uncertainties, and generally, it is not possible to predict the outcome of any particular litigation pending against Reynolds Defendants, or to reasonably estimate the amount or range of any possible loss.

Although RAI and its subsidiaries believe that they have valid bases for appeals of adverse verdicts in their pending cases and valid defenses to all actions and intend to defend them vigorously as described above, it is possible that there could be further adverse developments in pending cases, and that additional cases could be decided unfavorably against Reynolds Defendants. Determinations of liability or adverse rulings in such cases or in similar cases involving other cigarette manufacturers as defendants, even if such judgments are not final, could have a material adverse effect on the litigation against Reynolds Defendants and could encourage the commencement of additional tobacco-related litigation. Reynolds Defendants also may enter into settlement discussions in some cases, if they believe it is in their best interests to do so. In addition, a number of political, legislative, regulatory and other developments relating to the tobacco industry and cigarette smoking have

received wide media attention. These developments may negatively affect the outcomes of tobacco-related legal actions and encourage the commencement of additional similar litigation.

Although it is impossible to predict the outcome of such events on pending litigation and the rate new lawsuits may be filed against Reynolds Defendants, a significant increase in litigation or in adverse outcomes for tobacco defendants, or difficulties in obtaining the bonding required to stay execution of judgments on appeal, could have a material adverse effect on any or all of these entities. Moreover, notwithstanding the quality of defenses available to Reynolds Defendants in litigation matters, it is possible that RAI's results of operations, cash flows or financial position could be materially adversely affected by the ultimate outcome of certain pending litigation matters or future claims against Reynolds Defendants.

Similarly, smokeless tobacco litigation is subject to many uncertainties. Notwithstanding the quality of defenses available to American Snuff Co., it is possible that RAI's results of operations, cash flows or financial position could be materially adversely affected by the ultimate outcome of certain pending litigation matters against American Snuff Co.

Litigation Affecting the Cigarette Industry

Overview

Introduction. In connection with the B&W business combination, RJR Tobacco agreed to indemnify B&W and its affiliates against, among other things, certain litigation liabilities, costs and expenses incurred by B&W or its affiliates arising out of the U.S. cigarette and tobacco business of B&W. Also, as a result of the Lorillard Tobacco Merger, Lorillard Tobacco was merged into RJR Tobacco with RJR Tobacco being the surviving entity, Lorillard Tobacco ceasing to exist, and RJR Tobacco succeeding to Lorillard Tobacco's liabilities, including Lorillard Tobacco's litigation liabilities, costs and expenses. The cases discussed below include cases brought against RJR Tobacco, Lorillard Tobacco and their affiliates and indemnitees, including RAI, RJR, B&W and Lorillard. Also discussed are cases brought against SFNTC and RJR Vapor.

During the fourth quarter of 2015, 28 tobacco-related cases were served against Reynolds Defendants. On December 31, 2015, there were 268 cases pending against Reynolds Defendants: 251 in the United States and 17 in Canada, as compared with 177 total cases on December 31, 2014. The U.S. case number does not include the approximately 564 individual smoker cases pending in West Virginia state court as a consolidated action, 3,111 *Engle* Progeny cases, involving approximately 4,046 individual plaintiffs, and 2,499 *Broin II* cases, pending in the United States against RJR Tobacco, Lorillard Tobacco or their affiliates or indemnitees. Of the U.S. cases pending on December 31, 2015, 24 are pending in federal court, 226 in state court and 1 in tribal court, primarily in the following states: Maryland (43 cases); Illinois (35 cases); Florida (30 cases); New York (24 cases); Missouri (19 cases); Delaware (14 cases); and California (12 cases).

The following table lists the categories of the U.S. tobacco-related cases pending against Reynolds Defendants as of December 31, 2015, compared with the number of cases pending against Reynolds Defendants as of September 30, 2015, as reported in RAI's Quarterly Report on Form 10-Q for the fiscal quarter ended September 30, 2015, filed with the SEC on October 27, 2015, and a cross-reference to the discussion of each case type.

Case Type	U.S. Case Numbers as of December 31, 2015	Change in Number of Cases Since September 30, 2015 Increase/ (Decrease)	Page Reference
Individual Smoking and Health	118	No change	113
West Virginia IPIC (Number of Plaintiffs) *	1 (approx. 564)	(3)	114
Engle Progeny (Number of Plaintiffs) **	3,111 (approx. 4,046)	(462) (494)	115
Broin II	2,499	(41)	129
Class Action	28	4	130
Filter Cases	64	1	135
Health-Care Cost Recovery	2	No change	135
State Settlement Agreements — Enforcement and Validity; Adjustments	27	No change	142
Other Litigation and Developments	11	1	146

* Includes as one case the approximately 564 cases pending as a consolidated action *In Re: Tobacco Litigation Individual Personal Injury Cases,* sometimes referred to as *West Virginia IPIC* cases, described below. The *West Virginia IPIC* cases have been separated from the Individual Smoking and Health cases for reporting purposes.

** The *Engle* Progeny cases have been separated from the Individual Smoking and Health cases for reporting purposes. The number of cases has decreased as the result of many of the federal and state court cases being dismissed or duplicate actions being consolidated.

The following cases against RJR Tobacco, B&W and Lorillard Tobacco have attracted significant attention: the Florida state court class-action case, *Engle v. R. J. Reynolds Tobacco Co.* and the related *Engle* Progeny cases; and the case brought by the U.S. Department of Justice under the federal Racketeer Influenced and Corrupt Organizations Act, referred to as RICO.

In 2000, a jury in *Engle v. Liggett Group,* a class action brought against the major U.S. cigarette manufacturers by Florida smokers allegedly harmed by their addiction to nicotine, rendered a $145 billion punitive damages verdict in favor of the class. In 2006, the Florida Supreme Court set aside that award, prospectively decertified the class, and preserved several of the *Engle* jury findings for use in subsequent individual actions to be filed within one year of its decision. The preserved findings include jury determinations that smoking causes various diseases, that nicotine is addictive, and that each defendant sold cigarettes that were defective and unreasonably dangerous, committed unspecified acts of negligence and individually and jointly concealed unspecified information about the health risks of smoking.

In the wake of *Engle,* thousands of individual progeny actions were filed in federal and state courts in Florida against the major tobacco companies, including RJR Tobacco, B&W, Lorillard Tobacco and Philip Morris USA Inc. Such actions are commonly referred to as "*Engle* Progeny" cases. As of December 31, 2015, 27 *Engle* Progeny cases were pending in federal court, and 3,084 of them were pending in state court. These cases include approximately 4,046 plaintiffs. In addition, as of December 31, 2015, RJR Tobacco was aware of 9 additional *Engle* Progeny cases that had been filed but not served. One hundred eight *Engle* Progeny cases have been tried in Florida state and federal courts since the beginning of 2013, and numerous state court trials are scheduled for 2016. The number of pending cases fluctuates for a variety of reasons, including voluntary and involuntary dismissals. Voluntary dismissals include cases in which a plaintiff accepts an "offer of judgment," referred to in Florida statutes as "proposals for settlement," from RJR Tobacco, Lorillard Tobacco and/or RJR Tobacco's affiliates and indemnitees. An offer of judgment, if rejected by the plaintiff, preserves RJR Tobacco and Lorillard Tobacco's right to recover attorneys' fees under Florida law in the event of a verdict favorable to RJR Tobacco or Lorillard Tobacco. Such offers are sometimes made through court-ordered mediations.

During the first quarter of 2015, RJR Tobacco and Lorillard Tobacco, together with Philip Morris USA Inc., tentatively settled virtually all of the *Engle* Progeny cases then pending against them in federal district court. The total amount of the settlement was $100 million divided as follows: RJR Tobacco — $42.5 million; Philip Morris USA Inc. — $42.5 million; and Lorillard Tobacco — $15 million. The settlement, which received final approval from the court on November 6, 2015, covers more than 400 federal progeny cases but does not cover 12 federal progeny cases previously tried to verdict and currently pending on post-trial motions or appeal; one federal progeny case pending as of December 31, 2015, involving *pro se* plaintiffs unrepresented by counsel; and two federal progeny cases filed by different lawyers from the ones who negotiated the settlement for the plaintiffs. On August 3, 2015, RJR Tobacco and Philip Morris USA Inc. removed 33 cases from state court to the federal courts in Florida. These cases also are not part of the settlement described above, and were remanded back to state court on November 24, 2015. On October 22, 2015, RJR Tobacco and Philip Morris USA Inc. removed an additional five cases to federal court and, on January 4, 2016, removed a sixth case. At present, those cases remain in federal court. In March 2015, RJR Tobacco and Lorillard Tobacco paid their share of the settlement.

At the beginning of the *Engle* Progeny litigation, a central issue was the proper use of the preserved *Engle* findings. RJR Tobacco has argued that use of the *Engle* findings to establish individual elements of progeny claims (such as defect, negligence and concealment) is a violation of federal due process. In 2013, however, both the Florida Supreme Court and the U.S. Court of Appeals for the Eleventh Circuit, referred to as the Eleventh Circuit, rejected that argument. In addition to this global due process argument, RJR Tobacco and Lorillard Tobacco raise many other factual and legal defenses as appropriate in each case. These defenses may include, among other things, arguing that the plaintiff is not a proper member of the *Engle* class, that the plaintiff did not rely on any statements by any tobacco company, that the trial was conducted unfairly, that some or all claims are preempted or barred by applicable statutes of limitation, or that any injury was caused by the smoker's own conduct. In *Hess v. Philip Morris USA Inc.* and *Russo v. Philip Morris USA Inc.*, decided on April 2, 2015, the Florida Supreme Court held that, in *Engle* Progeny cases, the defendants cannot raise a statute of repose defense to claims for concealment or conspiracy. The defendants' motions for rehearing in each of these cases was denied in September 2015. On April 8, 2015, in *Graham v. R. J. Reynolds Tobacco Co.*, the Eleventh Circuit held that federal law impliedly preempts use of the preserved *Engle* findings to establish claims for strict liability or negligence. On January 21, 2016, the plaintiff's motion for rehearing *en banc* was granted. A briefing schedule has not been entered. On January 6, 2016, in *Marotta v. R. J. Reynolds Tobacco Co.*, the Fourth DCA disagreed with *Graham* and held that federal law does not impliedly preempt any tort claims against cigarette manufacturers, including those of *Engle* Progeny plaintiffs.

Thirty-five *Engle* Progeny cases that were tried have become final through December 31, 2015. These cases resulted in aggregate payments by RJR Tobacco or Lorillard Tobacco of $281.7 million ($214.9 million for compensatory and punitive damages and $66.8 million for attorneys' fees and statutory interest). Based on RJR Tobacco's evaluation, accruals for compensatory and punitive damages and attorneys' fees and statutory interest for *Hiott, Starr-Blundell, Clayton, Ward, Hallgren, Cohen, Sikes, Thibault, Buonomo, Taylor* and *Ballard* were recorded in RAI's consolidated balance sheet as of December 31, 2015. RJR Tobacco paid approximately $4.9 million in satisfaction of the judgment in *Taylor* on January 19, 2016. The following chart reflects the details of accrued compensatory and punitive damages related to *Hiott, Starr-Blundell, Clayton, Cohen, Buonomo, Hallgren, Sikes, Thibault, Taylor* and *Ballard.*

Plaintiff Case Name	RJR Tobacco Allocation of Fault	Lorillard Tobacco Allocation of Fault	Compensatory Damages (as adjusted) (1)	Punitive Damages	Appeal Status
Hiott	40%	0%	$ 730,000	$ —	Florida Supreme Court declined to accept jurisdiction of the case; the deadline to file a petition for writ of certiorari with the U.S. Supreme Court is May 2, 2016.
Starr-Blundell	10%	0%	50,000	—	Notice to invoke jurisdiction of Florida Supreme Court pending; stayed pending resolution of *Soffer v. R. J. Reynolds Tobacco Co.*
Clayton	10%	0%	60,000	—	First DCA affirmed the judgment of the trial court, per curiam
Cohen	33%	0%	3,330,000	10,000,000	Remanded for partial new trial; Florida Supreme Court accepted jurisdiction of the case, quashed the decision being reviewed, and reinstated the jury verdict; deadline to file a petition for writ of certiorari with the U.S. Supreme Court is April 28, 2016.
Buonomo	78%	0%	4,060,000	25,000,000	Remanded for new trial; Florida Supreme Court accepted jurisdiction of the case, quashed the decision being reviewed, and reinstated the jury verdict; appeal of the reinstated punitive damages award pending in Fourth DCA
Hallgren	25%	0%	500,000	750,000	Florida Supreme Court declined to accept jurisdiction; deadline to file a petition for writ of certiorari with the U.S. Supreme Court is April 11, 2016
Sikes	51%	0%	3,520,000	2,000,000	Florida Supreme Court declined to accept jurisdiction of the case; deadline to file a petition for writ of certiorari with the U.S. Supreme Court is May 2, 2016.
Thibault	70%	0%	1,750,000	1,275,000	First DCA affirmed the judgment, per curiam; Florida Supreme Court declined to accept jurisdiction of the case; deadline to file a petition for writ of certiorari with the U.S. Supreme Court is May 2, 2016.
Ballard	55%	0%	5,000,000	—	Florida Supreme Court declined to accept jurisdiction; deadline to file a petition for writ of certiorari with the U.S. Supreme Court is February 19, 2016
Taylor	58%	0%	4,116,000	521,000	First DCA affirmed the judgment, per curiam; RJR Tobacco paid approximately $4.9 million in satisfaction of the judgment on January 19, 2016.
Totals			$23,116,000	$39,546,000	

(1) Compensatory damages are adjusted to reflect the reduction that may be required by the allocation of fault. Punitive damages are not adjusted and reflect the amount of the final judgment(s) signed by the trial court judge(s). The amounts listed above do not include attorneys' fees or statutory interest of $18.5 million.

The following chart reflects verdicts in all other individual *Engle* Progeny cases, pending as of December 31, 2015, in which a verdict has been returned against RJR Tobacco or B&W or Lorillard Tobacco, or all three, and has not been set aside on appeal. No liability for any of these cases has been recorded in RAI's consolidated balance sheet as of December 31, 2015. This chart does not include the mistrials or verdicts returned in favor of RJR Tobacco or B&W or Lorillard Tobacco, or all three.

Plaintiff Case Name	RJR Tobacco Allocation of Fault	Lorillard Tobacco Allocation of Fault	Compensatory Damages (as adjusted) (1)	Punitive Damages	Appeal Status
Putney	30%	0%	$ —	$ —	Reversed and remanded for further proceedings; Florida Supreme Court accepted jurisdiction; quashed the decision being reviewed and reinstated the verdict; Defendants' motion for clarification pending.
Andy Allen	24%	0%	2,475,000	7,756,000	Reversed and remanded for new trial; new trial completed on November 26, 2014; pending — First DCA
Soffer	40%	0%	2,000,000	—	Pending — Florida Supreme Court
Ciccone	30%	0%	1,010,000	—	Pending — Florida Supreme Court
Calloway	27%	18%	16,100,000 (2)	—	Fourth DCA affirmed compensatory award (with instructions to reduce to reflect the smoker's fault if plaintiff does not agree to new trial), set aside punitive damages, and remanded for partial new trial
Hancock	5%	0%	700	—	Fourth DCA affirmed, per curiam; Plaintiff did not seek further review
James Smith	55%	0%	600,000 (2)	20,000	Pending — Eleventh Circuit
Evers	60%	9%	2,036,000	12,360,000	Second DCA reinstated punitive damage award of $12.36 million the trial court had set aside; case remanded for further proceedings that could affect the amount of damages
Schoeff	75%	0%	7,875,000	—	Fourth DCA affirmed compensatory award, set aside punitive award, and remanded for further proceedings; notice to invoke the discretionary jurisdiction of Florida Supreme Court pending
Marotta	58%	0%	3,480,000	—	Fourth DCA affirmed; notice to invoke the discretionary jurisdiction of the Florida Supreme Court due February 22, 2016
Searcy	30%	0%	1,000,000 (2)	1,670,000	Pending — Eleventh Circuit
Earl Graham	20%	0%	550,000	—	Eleventh Circuit held that federal law impliedly preempts claims for strict liability and negligence based on the defect and negligence findings from *Engle*; plaintiff's motion for rehearing was granted; briefing scheduled has not been entered
Skolnick	30%	0%	—	—	Fourth DCA set aside judgment and ordered a partial new trial
Grossman	75%	0%	15,350,000 (2)	22,500,000	Pending — Fourth DCA
Gafney	33%	33%	3,828,000	—	Pending — Fourth DCA
Cheeley	50%	0%	1,500,000	2,000,000	Fourth DCA affirmed judgment of trial court, per curiam; deadline to file motion for rehearing is February 12, 2016
Bowden	30%	0%	1,500,000	—	First DCA affirmed judgment of trial court, per curiam; deadline to file a motion for rehearing is February 17, 2016.

Plaintiff Case Name	RJR Tobacco Allocation of Fault	Lorillard Tobacco Allocation of Fault	Compensatory Damages (as adjusted) (1)	Punitive Damages	Appeal Status
Burkhart	25%	10%	3,500,000 (2)	1,750,000	Pending — Eleventh Circuit
Bakst (Odom)	75%	0%	4,504,000	14,000,000	Pending — Fourth DCA
Robinson	71%	0%	16,900,000	16,900,000	Pending — First DCA
Harris	15%	10%	1,223,500 (2)	—	Post-trial motions are pending (3)
Wilcox	70%	0%	4,900,000	8,500,000	Pending — Third DCA
Irimi	15%	15%	—	—	Defendants' motion for new trial granted; pending — Fourth DCA
Hubbird	50%	0%	3,000,000 (2)	25,000,000	Pending — Third DCA
Lourie	3%	7%	137,000	—	Pending — Second DCA
Kerrivan	31%	0%	6,046,660 (2)	9,600,000	Post-trial motions are pending (3)
Schleider	70%	0%	14,700,000 (2)	—	Pending — Third DCA
Perrotto	20%	6%	1,063,000	—	Post-trial motions are pending (3)
Ellen Gray	50%	0%	3,000,000	—	Post-trial motions are pending (3)
Sowers	50%	0%	2,130,000	—	Post-trial motions are pending (3)
Zamboni	30%	0%	102,000	—	Final judgment has not been entered
Pollari	43%	0%	4,250,000	1,500,000	Post-trial motions were denied; defendants filed a joint notice of appeal to the Fourth DCA on January 27, 2016
Gore	23%	0%	460,000	—	Pending — Fourth DCA
Ryan	65%	0%	21,500,000	25,000,000	Post-trial motions are pending (3)
Hardin	13%	0%	100,880	—	Post-trial motions are pending (3)
McCoy	25%	20%	670,000	6,000,000	Pending — Fourth DCA
Block	50%	0%	463,000	800,000	Pending — Fourth DCA
Lewis	25%	0%	187,500	—	Post-trial motions denied; final judgment has not been entered
Cooper	40%	0%	1,800,000	—	Post-trial motions were denied; Final judgment has not been entered
Duignan	30%	0%	2,690,000	2,500,000	Pending — Second DCA
O'Hara	85%	0%	14,700,000	20,000,000	Pending — First DCA
Marchese	22.5%	0%	500,000 (2)	250,000	Post-trial motion are pending (3)
Gordon	2%	0%	100	—	Plaintiff did not seek further review
Barbose	42.5%	0%	5,000,000	500,000	Post-trial motions were denied; final judgment has not been entered
Monroe	58%	0%	6,380,000	—	Post-trial motions are pending (3)
Ledoux	47%	0%	5,000,000	12,500,000	Post-trial motions are pending (3)
Ewing	2%	0%	4,800	—	Post-trial motions are due February 12, 2016
Totals			$184,217,140	$191,106,000	

(1) Unless otherwise noted, compensatory damages in these cases are adjusted to reflect the jury's allocation of comparative fault. Punitive damages are not so adjusted. The amounts listed above do not include attorneys' fees or statutory interest that may apply to the judgments and such fees and interest may be material.

(2) The court did not apply comparative fault in the final judgment.

(3) Should the pending post-trial motions be denied, RJR Tobacco will likely file a notice of appeal with the appropriate appellate court.

As of December 31, 2015, judgments in favor of the *Engle* Progeny plaintiffs have been entered and remain outstanding against RJR Tobacco or Lorillard Tobacco in the amount of $184,217,140 in compensatory damages (as adjusted) and in the amount of $191,106,000 in punitive damages, for a total of $375,323,140. All of these verdicts are at various stages in the post-trial or appellate process. RJR Tobacco continues to believe that RJR Tobacco and Lorillard Tobacco have valid defenses in these cases, including case-specific issues beyond the due process issue discussed above. It is the policy of RJR Tobacco and its affiliates to vigorously defend, as described in more detail above in "Accounting for Tobacco-Related Litigation Contingencies," smoking and health claims, including all *Engle* Progeny cases.

Should RJR Tobacco or Lorillard Tobacco not prevail in any particular individual *Engle* Progeny case or determine that in any individual *Engle* Progeny case an unfavorable outcome has become probable and the

amount can be reasonably estimated, a loss would be recognized, which could have a material adverse effect on the results of operations, cash flows and financial position of RAI in a particular quarter or year. This position on loss recognition for *Engle* Progeny cases as of December 31, 2015, is consistent with RAI's and RJR Tobacco's historic position on loss recognition for other smoking and health litigation. It is also the policy of RJR Tobacco to record any loss concerning litigation at such time as an unfavorable outcome becomes probable and the amount can be reasonably estimated on an individual case-by-case basis.

In the *U.S. Department of Justice* case, brought in 1999 in the U.S. District Court for the District of Columbia, the government sought, among other forms of relief, the disgorgement of profits pursuant to the civil provisions of RICO. The U.S. Court of Appeals for the District of Columbia, referred to as the D.C. Circuit, ruled in 2005 that disgorgement is not an available remedy in the case. The bench trial ended in June 2005, and the court, in August 2006, issued its ruling that, among other things, found certain defendants, including RJR Tobacco, Lorillard Tobacco and B&W, liable for the RICO claims, imposed no direct financial penalties on the defendants, but ordered the defendants to make certain "corrective communications" in a variety of media and enjoined the defendants from using certain brand descriptors. Both sides appealed to the D.C. Circuit. In May 2009, the D.C. Circuit largely affirmed the findings against the tobacco company defendants and remanded the case to the trial court for further proceedings. The U.S. Supreme Court denied the parties' petitions for writ of certiorari in June 2010. In June 2014, the district court issued an implementation order for the corrective-statements remedy. That order stays implementation until the exhaustion of the defendants' appeal challenging the legality of the corrective statements. On May 22, 2015, the D.C. Circuit issued an opinion on the legality of the corrective statements, affirming them in part and reversing them in part. Additional remand proceedings remain ongoing.

For a detailed description of these cases, see "— *Engle* and *Engle* Progeny Cases" and "— Health-Care Cost Recovery Cases — U.S. Department of Justice Case" below.

In November 1998, the major U.S. cigarette manufacturers, including RJR Tobacco, B&W and Lorillard Tobacco, entered into the MSA with 46 U.S. states, Washington, D.C. and certain U.S. territories and possessions. These cigarette manufacturers previously settled four other cases, brought on behalf of Mississippi, Florida, Texas and Minnesota, by separate agreements with each state. These State Settlement Agreements:

- settled all health-care cost recovery actions brought by, or on behalf of, the settling jurisdictions;
- released the major U.S. cigarette manufacturers from various additional present and potential future claims;
- imposed future payment obligations in perpetuity on RJR Tobacco, B&W, Lorillard Tobacco and other major U.S. cigarette manufacturers; and
- placed significant restrictions on their ability to market and sell cigarettes and smokeless tobacco products.

Payments under the State Settlement Agreements are subject to various adjustments for, among other things, the volume of cigarettes sold, relative market share, operating profit and inflation. See "— Health-Care Cost Recovery Cases — State Settlement Agreements" below for a detailed discussion of the State Settlement Agreements, including RAI's operating subsidiaries' monetary obligations under these agreements. RJR Tobacco records the allocation of settlement charges as products are shipped.

Scheduled Trials. Trial schedules are subject to change, and many cases are dismissed before trial. There are 26 cases, exclusive of *Engle* Progeny cases, scheduled for trial as of December 31, 2015 through December 31, 2016, for RJR Tobacco, B&W, Lorillard Tobacco or their affiliates and indemnitees: one non-smoking and health case, one class action, three individual smoking and health cases and 21 Filter Cases. There are approximately 93 *Engle* Progeny cases against RJR Tobacco, B&W and/or Lorillard Tobacco set for trial through December 31, 2016, but it is not known how many of these cases will actually be tried.

Trial Results. From January 1, 2013 through December 31, 2015, 112 smoking and health, *Engle* Progeny and health-care cost recovery cases in which RJR Tobacco, B&W and/or Lorillard Tobacco were defendants were tried, including seven trials for cases where mistrials were declared in the original proceedings. Verdicts in favor of RJR Tobacco, B&W and Lorillard Tobacco and, in some cases, RJR Tobacco, B&W, Lorillard Tobacco and/or other defendants, were returned in 53 cases, including 12 mistrials, tried in Florida (52) and West Virginia (1). Verdicts in favor of the plaintiffs were returned in 53 cases tried in Florida, and 1 in California. Three cases in Florida were dismissed during trial. One case in Florida was a retrial only as to the amount of damages. In another case in Florida, the jury entered a partial verdict that did not include compensatory or punitive damages, and post-trial motions are pending.

In the fourth quarter of 2015, nine *Engle* Progeny cases in which RJR Tobacco and/or Lorillard Tobacco was a defendant were tried:

- In *Marchese v. R. J. Reynolds Tobacco Co.*, the jury returned a verdict in favor of the plaintiff, found the decedent 55% at fault, RJR Tobacco 22.5% at fault, and the remaining defendant 22.5% at fault, and awarded $1 million in compensatory damages. The jury also awarded $250,000 in punitive damages against each defendant.
- In *Gordon v. R. J. Reynolds Tobacco Co*., the jury returned a verdict in favor of the plaintiff, found the decedent 98% at fault and RJR Tobacco 2% at fault, and awarded $5,000 in compensatory damages. Punitive damages were not awarded.
- In *Robertson v. R. J. Reynolds Tobacco Co.*, the jury returned a verdict in favor of RJR Tobacco.
- In *Barbose v. R. J. Reynolds Tobacco Co.*, the jury returned a verdict in favor of the plaintiff, found the decedent 15% at fault, RJR Tobacco 42.5% at fault and the remaining defendant 42.5% at fault, and awarded $10 million in compensatory damages and $1 million in punitive damages against each defendant. The damages are to be split equally.
- In *Fanali v. R. J. Reynolds Tobacco Co.*, the jury returned a verdict in favor of RJR Tobacco.
- In *Shulman v. R. J. Reynolds Tobacco Co.*, the jury returned a verdict in favor of the defendants, including RJR Tobacco.
- In *Green v. R. J. Reynolds Tobacco Co.*, the jury returned a verdict in favor of RJR Tobacco.
- In *Monroe v. R. J. Reynolds Tobacco Co.*, the jury returned a verdict in favor of the plaintiff, found the decedent 42% at fault and RJR Tobacco 58% at fault, and awarded $11 million in compensatory damages. No punitive damages were awarded.
- In *Ledoux v. R. J. Reynolds Tobacco Co.*, the jury returned a verdict in favor of the plaintiff, found the decedent 6% at fault, RJR Tobacco 47% at fault and the remaining defendant 47% at fault, and awarded $10 million in compensatory damages and $12.5 million in punitive damages against each defendant.

In addition, since the end of the fourth quarter of 2015, three other *Engle* Progeny cases, in which RJR Tobacco and/or Lorillard Tobacco were a defendant, were tried:

- In *Howles v. R. J. Reynolds Tobacco Co.*, the court declared a mistrial because the jury was unable to reach a unanimous verdict.
- In *Rounds v. R. J. Reynolds Tobacco Co.*, the jury returned a verdict in favor of RJR Tobacco.
- In *Ewing v. R. J. Reynolds Tobacco Co*., the jury returned a verdict in favor of the plaintiff, found the decedent 98% at fault, RJR Tobacco 2% at fault and the remaining defendant 0% at fault, and awarded $240,000 in compensatory damages. Punitive damages were not awarded.

For a detailed description of the above-described cases, see "— *Engle* and *Engle* Progeny Cases" below.

In the fourth quarter of 2015, no non-*Engle* Progeny individual smoking and health cases, in which RJR Tobacco, B&W or Lorillard Tobacco was a defendant, were tried.

For information on the verdicts in the *Engle* Progeny cases that have been tried and remain pending as of December 31, 2015, in which verdicts have been returned against RJR Tobacco, Lorillard Tobacco or B&W, or all three, see the *Engle* Progeny cases charts above. The following chart reflects the verdicts in the non-*Engle* Progeny smoking and health cases, health-care cost recovery cases or Filter Cases that have been tried and remain pending as of December 31, 2015, in which verdicts have been returned against RJR Tobacco, B&W or Lorillard Tobacco, or all three.

Date of Verdict	Case Name/Type	Jurisdiction	Verdict
August 17, 2006	*United States v. Philip Morris USA, Inc.* [Governmental Health-Care Cost Recovery]	U.S. District Court, District of Columbia (Washington, DC)	RJR Tobacco, B&W and Lorillard Tobacco were found liable for civil RICO claims; were enjoined from using certain brand descriptors and from making certain misrepresentations; and were ordered to make corrective communications on five subjects, including smoking and health and addiction, to reimburse the U.S. Department of Justice appropriate costs associated with the lawsuit, and to maintain document web sites.
May 26, 2010	*Izzarelli v. R. J. Reynolds Tobacco Co.* [Individual]	U.S. District Court, District of Connecticut, (Bridgeport, CT)	$13.76 million in compensatory damages; 58% of fault assigned to RJR Tobacco, which reduced the award to $8.08 million against RJR Tobacco; $3.97 million in punitive damages.
September 13, 2013	*DeLisle v. A. W. Chesterton Co.* [Filter]	Circuit Court, Broward County, (Ft. Lauderdale, FL)	$8 million in compensatory damages; 44% of fault assigned to Lorillard Tobacco, which reduced the award to $3.52 million against Lorillard Tobacco.
July 30, 2014	*Major v. Lorillard Tobacco Co.* [Individual]	Superior Court, Los Angeles County, (Los Angeles, CA)	$17.74 million in compensatory damages; 17% of fault assigned to Lorillard Tobacco.
July 8, 2015	*Larkin v. R. J. Reynolds Tobacco Co.* [Individual]	Circuit Court, Miami-Dade County, (Miami, FL)	$4.96 million in compensatory damages; 62% of fault assigned to RJR Tobacco; $8.5 million in punitive damages.

For information on the post-trial status of individual smoking and health cases, the governmental health-care cost recovery case and the Filter Cases, see "— Individual Smoking and Health Cases," "— Health-Care Cost Recovery Cases — U.S. Department of Justice Case," and "— Filter Cases," respectively, below.

Individual Smoking and Health Cases

As of December 31, 2015, 118 individual cases were pending in the United States against RJR Tobacco, B&W (as RJR Tobacco's indemnitee), Lorillard Tobacco or all three. This category of cases includes smoking and health cases alleging personal injury brought by or on behalf of individual plaintiffs, but does not include the *Broin II, Engle* Progeny or *West Virginia IPIC* cases discussed below. A total of 117 of the individual cases are brought by or on behalf of individual smokers or their survivors, while the remaining case is brought by or on behalf of an individual or his/her survivors alleging personal injury as a result of exposure to environmental tobacco smoke, referred to as ETS.

Below is a description of the non-*Engle* Progeny individual smoking and health cases against RJR Tobacco, B&W or Lorillard Tobacco, or all three, which went to trial or were decided during the period from January 1, 2015 to December 31, 2015, or remained on appeal as of December 31, 2015.

On May 26, 2010, the jury returned a verdict in favor of the plaintiff in *Izzarelli v. R. J. Reynolds Tobacco Co.*, a case filed in December 1999 in the U.S. District Court for the District of Connecticut. The plaintiff sought to recover damages for personal injuries allegedly sustained as a result of unsafe and unreasonably dangerous cigarette products and for economic losses she sustained as a result of supposed unfair trade practices. The district court granted summary judgment to RJR Tobacco on the plaintiff's claim for unfair trade practices. After a trial on the negligence and strict liability claims, the jury returned a verdict finding RJR Tobacco to be 58% at fault and the plaintiff to be 42% at fault, awarding $13.76 million in compensatory damages and finding the

plaintiff to be entitled to punitive damages. In December 2010, the district court awarded the plaintiff $3.97 million in punitive damages. Final judgment was entered in December 2010, in the amount of $11.95 million. The district court granted the plaintiff's motion for offer of judgment interest, and awarded the plaintiff $15.8 million for the period of December 6, 1999 up to and including December 5, 2010, and approximately $4,000 per day thereafter until an amended judgment was entered. The amended judgment was entered in the amount of approximately $28.1 million in March 2011. In September 2011, RJR Tobacco filed a notice of appeal in the U.S. Court of Appeals for the Second Circuit, referred to as the Second Circuit, and the plaintiff thereafter cross appealed with respect to the punitive damages award. In September 2013, the Second Circuit certified the following question to the Connecticut Supreme Court: "Does Comment i to section 402A of the Restatement (Second) of Torts preclude a suit premised on strict products liability against a cigarette manufacturer based on evidence that the defendant purposefully manufactured cigarettes to increase daily consumption without regard to the resultant increase in exposure to carcinogens, but in the absence of evidence of any adulteration or contamination?" Subsequently, the plaintiff moved in the Second Circuit to amend the certification order to add a second question to the Connecticut Supreme Court: "Does Comment i to section 402A of the Restatement (Second) of Torts preclude a claim under the [Connecticut Products Liability Act] against a cigarette manufacturer for negligence (in the design of its cigarette products)?" The Second Circuit denied the plaintiff's motion to amend. The Connecticut Supreme Court accepted the certified question and overruled the plaintiff's objection that sought to amend the certification order to add the same additional question that the plaintiff had proposed to the Second Circuit. Oral argument in the Connecticut Supreme Court occurred on April 22, 2015. A decision is pending. The Second Circuit has retained jurisdiction over the parties' appeals and will decide the case after the Connecticut Supreme Court has completed its proceedings.

On June 19, 2013, in *Whitney v. R. J. Reynolds Tobacco Co.*, the jury returned a verdict in favor of the defendants, including RJR Tobacco. The case was filed in January 2011, in the Circuit Court, Alachua County, Florida. The plaintiff alleged that as a result of using the defendants' products, she suffers from lung cancer and emphysema, and sought an unspecified amount of compensatory and punitive damages, costs and interest. Final judgment was entered in July 2013. The plaintiff filed a notice of appeal to the First DCA in August 2013. On December 5, 2014, the First DCA reversed the trial court's directed verdict in favor of the defendants on the plaintiff's design defect claims, affirmed on all other issues, and remanded the case for a new trial. On February 26, 2015, the First DCA denied the defendants' motion for panel rehearing, rehearing en banc, or certification to the Florida Supreme Court. The new trial has not been scheduled.

On July 30, 2014, in *Major v. Lorillard Tobacco Co.*, a case filed in November 2011, in the Superior Court, Los Angeles County, California, the jury returned a verdict in favor of the plaintiff, found the plaintiff 50% at fault, Lorillard Tobacco 17% at fault, and RJR Tobacco and another manufacturer collectively 33% at fault. RJR Tobacco and the other manufacturer were dismissed prior to trial. The jury awarded approximately $17.74 million in compensatory damages. The plaintiffs alleged that as a result of the use of the defendants' products and exposure to asbestos, the decedent, William Major, suffered from lung cancer, and sought an unspecified amount of damages. In August 2014, an initial final judgment was entered against Lorillard Tobacco in the amount of approximately $3.9 million. In November 2014, Lorillard Tobacco filed a notice of appeal to the California District Court of Appeal and posted a supersedeas bond in the amount of approximately $9 million. The plaintiff filed a notice of cross appeal in December 2014. On July 1, 2015, the trial court entered an amended final judgment in the amount of approximately $3.78 million in compensatory damages, approximately $135,000 in costs, approximately $1.9 million in prejudgment interest, and post-judgment interest from August 25, 2014 in the amount of approximately $1,100 per day. Lorillard Tobacco filed a notice of appeal from the amended final judgment, and the California District Court of Appeal ordered the appeals consolidated. On October 15, 2015, RJR Tobacco filed a stipulation to substitute RJR Tobacco for Lorillard Tobacco, which was granted on October 20, 2015. A briefing schedule for the appeal has not been entered.

On July 8, 2015, in *Larkin v. R. J. Reynolds Tobacco Co.*, a case filed in January 2002, in the Circuit Court, Miami-Dade County, Florida, the jury returned a verdict in favor of the plaintiff, found the decedent, Carole Larkin, 38% at fault, RJR Tobacco 62% at fault, and awarded approximately $4.96 million in compensatory damages and $8.5 million in punitive damages. The plaintiff alleged that as a result of using the defendant's products, the decedent suffered from mouth and lung cancer, and sought an unspecified amount of compensatory and punitive damages. Final judgment was entered in the amount of approximately $13.46 million on July 15, 2015. Post-trial motions are pending.

West Virginia IPIC

In re: Tobacco Litigation Individual Personal Injury Cases began in 1999, in West Virginia state court, as a series of roughly 1,200 individual plaintiff cases making claims with respect to cigarettes manufactured by Philip Morris USA Inc., Lorillard Tobacco, RJR Tobacco, B&W and The American Tobacco Company. The cases were consolidated for a Phase I trial on various defense conduct issues, to be followed in Phase II by individual trials of any claims left standing. Over the years, approximately 600 individual plaintiff claims were dismissed for failure to comply with the case management order, leaving 567 individual cases pending as of April 2013. On April 15, 2013, the Phase I jury trial began and ended with a virtually complete defense verdict on May 15, 2013. The jury found that cigarettes were not defectively designed, were not defective due to a failure to warn prior to July 1, 1969, that defendants were not negligent, did not breach warranties and did not engage in conduct which would warrant punitive damages. The only claim remaining after the verdict was the jury's finding that all ventilated filter cigarettes manufactured and sold between 1964 and July 1, 1969 were defective for a failure to instruct. In November 2014, the West Virginia Supreme Court affirmed the verdict, issuing an opinion without oral argument. In January 2015, the plaintiffs' petition for rehearing was denied. On June 8, 2015, the plaintiffs' petition for writ of certiorari to the U.S. Supreme Court was denied. Also on June 8, 2015, the trial court ruled in favor of the defendants' contention that there are only 30 plaintiffs remaining who arguably claim to have smoked a ventilated filter cigarette during the relevant period. The claims will be limited to compensatory damages only and will focus on whether the plaintiff actually blocked vents while smoking and, if so, whether such blocking is a proximate cause of the alleged injury. On October 9, 2015, the trial court outlined the procedures it will follow for resolving the claims of the 30 Phase II plaintiffs. Five cases have been selected to be the first claims tried, and they are scheduled to proceed to trial on May 1, 2017.

In addition to the foregoing claims, various plaintiffs in 1999 and 2000 asserted claims against retailers and distributors. Those claims were severed and stayed pending the outcome of Phase I. Also, 41 plaintiffs asserted smokeless tobacco claims against various smokeless manufacturers including American Snuff Co. Those claims were severed from IPIC in 2001, and the plaintiffs took no action to prosecute the claims. They have recently sought to activate those claims. The defendants will assert various defenses to all of these claims, including that all of the additional claims were either covered by the Phase I verdict or abandoned.

Engle and Engle Progeny Cases

Trial began in July 1998 in *Engle v. R. J. Reynolds Tobacco Co.,* a class action filed in Circuit Court, Miami-Dade County, Florida. The *Engle* class consisted of Florida citizens and residents, and their survivors, who suffer from or have died from diseases or medical conditions caused by an addiction to smoking. The action was brought against the major U.S. cigarette manufacturers, including RJR Tobacco, B&W and Lorillard Tobacco. In July 1999, the *Engle* jury found against RJR Tobacco, B&W, Lorillard Tobacco and the other defendants in the initial phase of the trial, which addressed alleged common issues related to the defendants' conduct, general causation, the addictiveness of cigarettes, and potential entitlement to punitive damages.

On July 14, 2000, in the second phase of the trial, the jury returned a punitive damages verdict in favor of the class of approximately $145 billion, including verdicts of $36.3 billion against RJR Tobacco, $17.6 billion against B&W, and $16.3 billion against Lorillard Tobacco.

On appeal, the Florida Supreme Court prospectively decertified the class, and it set aside the punitive damages award as both premature and excessive. However, the court preserved a number of findings from Phase I of the trial, including findings that cigarettes can cause certain diseases, that nicotine is addictive, and that defendants placed defective cigarettes on the market, breached duties of care, and concealed health-related information about cigarettes. The court authorized former class members to file individual lawsuits within one year, and it stated that the preserved findings would have res judicata effect in those actions.

In the wake of the Florida Supreme Court ruling, thousands of individuals filed separate lawsuits seeking to benefit from the *Engle* findings. As of December 31, 2015, RJR Tobacco and/or Lorillard Tobacco were defendants in 3,111 *Engle* Progeny cases in both state and federal courts in Florida. These cases include approximately 4,046 plaintiffs. Many of these cases are in active discovery or nearing trial. During the first quarter of 2015, RJR Tobacco and Lorillard Tobacco, together with Philip Morris USA Inc., tentatively settled virtually all of the *Engle* Progeny cases then pending against them in federal district court. The total amount of the settlement was $100 million divided as follows: RJR Tobacco — $42.5 million; Philip Morris USA Inc. — $42.5 million; and Lorillard Tobacco — $15 million. The settlement, which received final approval from the court on November 6, 2015, covers more than 400 federal progeny cases but does not cover 12 federal progeny cases previously tried to verdict and currently pending on post-trial motions or appeal; one federal progeny case pending as of December 31, 2015 involving *pro se* plaintiffs unrepresented by counsel; and 2 federal progeny

cases filed by different lawyers from the ones who negotiated the settlement for the plaintiffs. On August 3, 2015, RJR Tobacco and Philip Morris USA Inc. removed 33 *Engle* Progeny cases from state court to the federal courts in Florida. These cases also are not part of the settlement described above and were remanded back to state court on November 24, 2015. On October 22, 2015, RJR Tobacco and Philip Morris USA Inc. removed an additional five cases to federal court and, on January 4, 2016, removed a sixth case. At present, those cases remain in federal court. In March 2015, RJR Tobacco and Lorillard Tobacco paid their shares of the settlement.

At the beginning of the *Engle* Progeny litigation, a central issue was the proper use of the preserved *Engle* findings. RJR Tobacco has argued that use of the *Engle* findings to establish individual elements of progeny claims (such as defect, negligence and concealment) is a violation of federal due process. In 2013, however, both the Florida Supreme Court and the Eleventh Circuit rejected that argument. RJR Tobacco continues to press various other factual and legal defenses as appropriate in each case, including defenses based on express and implied preemption.

In June 2009, Florida amended its existing bond cap statute by adding a $200 million bond cap that applied to all *Engle* Progeny cases in the aggregate. In May 2011, Florida removed the provision that would have allowed it to expire on December 31, 2012. The bond cap for any given individual *Engle* Progeny case varies depending on the number of judgments in effect at a given time, but never exceeds $5 million per case. The legislation, which became effective in June 2009 and 2011, applies to judgments entered after the original 2009 effective date.

Below is a description of the *Engle* Progeny cases against RJR Tobacco, B&W or Lorillard Tobacco, or all three that went to trial or were decided during the period from January 1, 2015 to December 31, 2015, or remained on appeal as of December 31, 2015.

On February 25, 2010, in *Grossman v. R. J. Reynolds Tobacco Co*., a case filed in December 2007, in the Circuit Court, Broward County, Florida, the court declared a mistrial due to the jury's inability to reach a decision. The plaintiff alleged that as a result of an addiction to cigarettes, the decedent, Laura Grossman, developed lung cancer and died. The plaintiff sought an unspecified amount of damages and all taxable costs and interest. Retrial began in March 2010. In April 2010, the jury returned a verdict in favor of the plaintiff in Phase I, and in Phase II awarded $1.9 million in compensatory damages and no punitive damages. The jury also found RJR Tobacco to be 25% at fault, the decedent to be 70% at fault and the decedent's spouse to be 5% at fault. Final judgment was entered in June 2010, in the amount of $483,682. RJR Tobacco filed a notice of appeal to the Fourth DCA, and posted a supersedeas bond in the amount of approximately $484,000. The plaintiff filed a notice of cross appeal. In June 2012, the Fourth DCA entered an opinion that affirmed the trial court's judgment, but remanded the case for a new trial on all Phase II issues. In October 2012, RJR Tobacco filed a notice to invoke the discretionary jurisdiction of the Florida Supreme Court. In February 2014, the Florida Supreme Court declined to accept jurisdiction of the appeal of the original verdict. Retrial began on July 11, 2013. On July 31, 2013, the jury returned a verdict in favor of the plaintiff, found the decedent to be 25% at fault and RJR Tobacco to be 75% at fault, and awarded $15.35 million in compensatory damages and $22.5 million in punitive damages. Final judgment was entered in August 2013 and did not include a reduction for comparative fault. RJR Tobacco filed a notice of appeal to the Fourth DCA and the plaintiff filed a notice of cross appeal in October 2013. RJR Tobacco's original bond was returned, and RJR Tobacco posted a new bond in the amount of $5 million. Briefing is complete. Oral argument has not been scheduled.

On March 10, 2010, in *Cohen v. R. J. Reynolds Tobacco Co*., a case filed in May 2007, in the Circuit Court, Broward County, Florida, a jury returned a verdict in favor of the plaintiff. The plaintiff alleged that the decedent, Nathan Cohen, developed lung cancer as a result of using the defendants' products, and sought an unspecified amount of compensatory and punitive damages. On March 24, 2010, the jury awarded the plaintiff $10 million in compensatory damages, and found the decedent to be 33.3% at fault, RJR Tobacco to be 33.3% at fault and the remaining defendant to be 33.3% at fault. The jury also awarded $20 million in punitive damages, of which $10 million was assigned to RJR Tobacco. In July 2010, the court entered final judgment against RJR Tobacco in the amount of $3.33 million in compensatory damages and $10 million in punitive damages. The court entered an amended judgment in September 2010 to include interest from the date of the verdict. RJR Tobacco filed a notice of appeal to the Fourth DCA and posted a supersedeas bond in the amount of $2.5 million. In September 2012, the Fourth DCA affirmed the liability finding and the compensatory damages award, but reversed the finding of entitlement to punitive damages, and remanded the case for a retrial limited to the issue of liability for concealment and conspiracy. The defendants and the plaintiff filed separate notices to invoke the discretionary jurisdiction of the Florida Supreme Court in January 2013. In February 2014, the Florida Supreme Court, on its own motion, consolidated the petitions for review filed by the plaintiff and RJR Tobacco and stayed the petitions pending disposition by the court of *Hess v. Philip Morris USA Inc.*, which dealt with the application of the statute of repose

as an affirmative defense to claims of fraudulent concealment and conspiracy to commit fraudulent concealment. On April 2, 2015, in *Hess*, the Florida Supreme Court held that, in *Engle* Progeny cases, the defendants cannot raise a statute of repose defense to claims for concealment or conspiracy. On January 29, 2016, the Florida Supreme Court accepted jurisdiction of the case, quashed the decision being reviewed, and reinstated the jury verdict. The deadline to file a petition for writ of certiorari with the U.S. Supreme Court is April 28, 2016.

On April 26, 2010, in *Putney v. R. J. Reynolds Tobacco Co.*, a case filed in December 2007 in the Circuit Court, Broward County, Florida, a jury returned a verdict in favor of the plaintiff, found the decedent, Margot Putney, to be 35% at fault, RJR Tobacco to be 30% at fault and the remaining defendants collectively to be 35% at fault, and awarded $15.1 million in compensatory damages and $2.5 million in punitive damages each against RJR Tobacco and the remaining defendants. The plaintiff alleged that the decedent suffered from nicotine addiction and lung cancer as a result of using the defendants' products and sought an unspecified amount of compensatory and punitive damages. In August 2010, final judgment was entered against RJR Tobacco in the amount of $4.5 million in compensatory damages, and $2.5 million in punitive damages. RJR Tobacco filed a notice of appeal and the plaintiff filed a notice of cross appeal. In December 2010, the court entered an amended final judgment to provide that interest would run from April 26, 2010. The defendants filed a joint notice of appeal to the Fourth DCA of the amended final judgment, and RJR Tobacco posted a supersedeas bond in the amount of approximately $2.4 million. In June 2013, the Fourth DCA held that the court erred in denying the defendants' motion for remittitur of the compensatory damages for loss of consortium and in striking the defendants' statute of repose affirmative defenses. As a result, the verdict was reversed, and the case was remanded for further proceedings. In August 2013, the plaintiff's motion for rehearing, written opinion on one issue, or certification of conflict to the Florida Supreme Court was denied. The defendants and the plaintiff filed separate notices to invoke the discretionary jurisdiction of the Florida Supreme Court in September 2013. In December 2013, the Florida Supreme Court consolidated the petitions for review filed by the plaintiff and the defendants and stayed the petitions pending disposition of *Hess v. Philip Morris USA Inc.,* described above. On April 2, 2015, in *Hess*, the Florida Supreme Court held that, in *Engle* Progeny cases, the defendants cannot raise a statute of repose defense to claims for concealment or conspiracy. The Florida Supreme Court accepted jurisdiction, quashed the decision being reviewed and reinstated the verdict. Defendants' motion for clarification is pending.

On May 20, 2010, in *Buonomo v. R. J. Reynolds Tobacco Co.*, a case filed in October 2007, in the Circuit Court, Broward County, Florida, a jury returned a verdict in favor of the plaintiff, found RJR Tobacco to be 77.5% at fault and the decedent, Matthew Buonomo, to be 22.5% at fault, and awarded $5.2 million in compensatory damages and $25 million in punitive damages. The plaintiff alleged that the decedent was addicted to cigarettes and, as a result, developed one or more smoking-related medical conditions and/or diseases and sought an unspecified amount of compensatory and punitive damages. Post-trial motions were denied, but the court, in accordance with the Florida statutory limitation on punitive damage awards, ordered the punitive damage award of $25 million be reduced to $15.7 million — three times the compensatory damages award of $5.2 million. In August 2010, the court entered final judgment in the amount of $4.06 million in compensatory damages and $15.7 million in punitive damages. RJR Tobacco filed a notice of appeal to the Fourth DCA and posted a supersedeas bond in the amount of $5 million. The plaintiff filed a notice of cross appeal. In September 2013, the Fourth DCA affirmed the final judgment and damages award to the plaintiff on strict liability and negligence and held that the trial court was not bound to hold punitive damages at three times compensatory damages. However, the court reversed the judgment entered for the plaintiff on the claims for fraudulent concealment and conspiracy to commit fraud by concealment due to the erroneous striking of RJR Tobacco's statute of repose defense. As a result, the punitive damages award was set aside and remanded for a new trial. In January 2014, RJR Tobacco and the plaintiff filed notices to invoke the discretionary jurisdiction of the Florida Supreme Court. In June 2014, the Florida Supreme Court stayed the petitions for review pending disposition by the court of *Hess v. Philip Morris USA Inc.*, described above. On April 2, 2015, in *Hess*, the Florida Supreme Court held that, in *Engle* Progeny cases, the defendants cannot raise a statute of repose defense to claims for concealment or conspiracy. The trial court determined in October 2014 that the original $25 million punitive damages award was not excessive and would be reinstated if the plaintiff prevails on the repose issue. An amended final judgment was entered in April 2015 against RJR Tobacco in the amount of approximately $29.1 million. RJR Tobacco filed a notice of appeal to the Fourth DCA in May 2015. Briefing is underway. On January 26, 2016, the Florida Supreme Court accepted jurisdiction of the case, summarily quashing the decision being reviewed, and reinstated the jury verdict. Defendant's motion for clarification is pending.

On October 15, 2010, in *Frazier v. Philip Morris USA Inc.*, now known as *Russo v. Philip Morris USA Inc.*, a case filed in December 2007 in the Circuit Court, Miami-Dade County, Florida, a jury returned a verdict in favor of the defendants. The plaintiff alleged that as a result of smoking defendants' products, including RJR

Tobacco's, she developed chronic obstructive pulmonary disease, and sought an unspecified amount of compensatory and punitive damages. Final judgment was entered in February 2011. The plaintiff filed a notice of appeal to the Third DCA, and the defendants filed a notice of cross appeal. In April 2012, the Third DCA reversed the trial court's judgment, directed entry of judgment in the plaintiff's favor and ordered a new trial. In July 2012, the defendants filed a notice to invoke the discretionary jurisdiction of the Florida Supreme Court. The Florida Supreme Court accepted jurisdiction of the case in September 2013. Oral argument in the Florida Supreme Court occurred on April 30, 2014. On April 2, 2015, the Florida Supreme Court approved the decision of the Third DCA. Following its decision in *Hess*, the Florida Supreme Court held that the statute of repose is unavailable as a defense to concealment and conspiracy claims in *Engle* Progeny cases. Retrial began on April 6, 2015. On April 23, 2015, the jury returned a verdict in favor of the defendants, including RJR Tobacco. Final judgment was entered in May 2015. In June 2015, the plaintiff filed a notice of appeal to the Third DCA, and the defendants filed a notice of cross appeal. Briefing is underway.

On April 26, 2011, in *Andy Allen v. R. J. Reynolds Tobacco Co*., a case filed in September 2007, in the Circuit Court, Duval County, Florida, a jury returned a verdict in favor of the plaintiff, found RJR Tobacco to be 45% at fault, the decedent, Patricia Allen, to be 40% at fault and the remaining defendant to be 15% at fault, and awarded $6 million in compensatory damages and $17 million in punitive damages against each defendant. The plaintiff alleged that as a result of smoking the defendants' products, the decedent developed chronic obstructive pulmonary disease, and sought an unspecified amount of compensatory damages. Final judgment was entered against RJR Tobacco in the amount of $19.7 million in May 2011. In October 2011, the trial court entered a remittitur of the punitive damages to $8.1 million and denied all other post-trial motions. The defendants filed a joint notice of appeal, RJR Tobacco posted a supersedeas bond in the amount of $3.75 million, and the plaintiff filed a notice of cross appeal in November 2011. In May 2013, the First DCA reversed the trial court's judgment and remanded the case for a new trial. The new trial began on November 1, 2014, and on November 26, 2014, the jury returned a verdict in favor of the plaintiff, found the decedent to be 70% at fault, RJR Tobacco to be 24% at fault and the remaining defendant to be 6% at fault, and awarded $3.1 million in compensatory damages and approximately $7.75 million in punitive damages against each defendant. Final judgment was entered in August 2015 against RJR Tobacco and the remaining defendant, jointly and severally, in the amount of approximately $3.1 million in compensatory damages and $7.75 million in punitive damages from each defendant. The defendants filed a notice of appeal in September 2015, and RJR Tobacco posted a supersedeas bond in the amount of approximately $2.5 million. Briefing is underway.

On June 16, 2011, in *Soffer v. R. J. Reynolds Tobacco Co*., a case filed in December 2007, in the Circuit Court, Alachua County, Florida, a jury returned a verdict in favor of the plaintiff, found RJR Tobacco to be 40% at fault, the decedent, Maurice Soffer, to be 60% at fault, and awarded $5 million in compensatory damages and no punitive damages. The plaintiff alleged that the decedent was addicted to cigarettes and, as a result, developed lung cancer and other smoking-related conditions and/or diseases, and sought an unspecified amount of compensatory damages. Final judgment was entered against RJR Tobacco in the amount of $2 million. The plaintiff filed a notice of appeal to the First DCA in July 2011. RJR Tobacco filed a notice of cross appeal and posted a supersedeas bond in the amount of $2 million. In October 2012, the First DCA affirmed the trial court's ruling in full. On the direct appeal, the court held that only intentional torts could support a punitive damages claim and held that *Engle* Progeny plaintiffs may not seek punitive damages for negligence or strict liability because the original *Engle* class did not seek punitive damages for those claims. The First DCA certified the question to the Florida Supreme Court as one of great public importance. On the cross appeal, the court rejected RJR Tobacco's arguments about the use of the *Engle* findings and the statute of limitations. RJR Tobacco and the plaintiff both filed notices to invoke the discretionary jurisdiction of the Florida Supreme Court. In February 2014, the Florida Supreme Court declined to accept jurisdiction of RJR Tobacco's petition for review and accepted the plaintiff's petition for review of the First DCA's decision. Oral argument occurred on December 4, 2014. A decision is pending.

On July 15, 2011, in *Ciccone v. R. J. Reynolds Tobacco Co*., a case filed in August 2004, in the Circuit Court, Broward County, Florida, a jury returned a verdict finding the plaintiff is a member of the *Engle* class. The plaintiff alleged that as a result of the use of the defendant's tobacco products, the decedent, George Ciccone, suffered from nicotine addiction and one or more smoking-related diseases and/or medical conditions, and sought an unspecified amount of compensatory and punitive damages. On July 21, 2011, the jury awarded approximately $3.2 million in compensatory damages and $50,000 in punitive damages. The jury found the decedent to be 70% at fault and RJR Tobacco to be 30% at fault. Final judgment was entered against RJR Tobacco in the amount of approximately $1.01 million in September 2011, and RJR Tobacco filed a notice of appeal to the Fourth DCA. RJR Tobacco posted a supersedeas bond in the amount of approximately $1 million

on October 17, 2011. In August 2013, the Fourth DCA affirmed the judgment of the trial court, but reversed the punitive damages award and remanded the case to the trial court for entry of a final judgment that eliminates the punitive damages award. The Florida Supreme Court accepted jurisdiction of the case in June 2014. Oral argument occurred on December 4, 2014. A decision is pending.

On January 24, 2012, in *Hallgren v. R. J. Reynolds Tobacco Co.,* a case filed in April 2007, in the Circuit Court, Highlands County, Florida, a jury returned a verdict in favor of the plaintiff, found the decedent, Claire Hallgren, to be 50% at fault, RJR Tobacco to be 25% at fault, and the remaining defendant to be 25% at fault, and awarded $2 million in compensatory damages and $750,000 in punitive damages against each defendant. The plaintiff alleged that the decedent was addicted to the defendants' products, and as a result, suffered from lung cancer, and sought an unspecified amount of compensatory and punitive damages. In March 2012, the court entered final judgment in the amount of approximately $1 million for which RJR Tobacco and the other defendant are jointly and severally liable; and $750,000 in punitive damages against each defendant. The defendants filed a joint notice of appeal to the Second DCA, and RJR Tobacco posted a supersedeas bond in the amount of approximately $1.3 million in May 2012. The plaintiff filed a notice of cross appeal. In October 2013, the Second DCA affirmed the trial court's ruling that punitive damages can be awarded for negligence and strict liability claims as well as for the intentional tort claims brought under *Engle*. The court certified a conflict with the First DCA's decision in *Soffer* and the Fourth DCA's decision in *Ciccone*. The court also certified the following question to be of great public importance — "Are members of the *Engle* class who pursue individual damages actions in accordance with the decision in *Engle v. Liggett Group, Inc.*, entitled to pursue punitive damages under claims for strict liability and negligence?" In November 2013, the defendants filed a notice to invoke the discretionary jurisdiction of the Florida Supreme Court. In June 2014, the Florida Supreme Court stayed the petition pending disposition of *Russo v. Philip Morris USA Inc.,* described above, and in April 2015, stayed the petition pending disposition of *Soffer v. R. J. Reynolds Tobacco Co.*, described above. The Florida Supreme Court issued an order to show cause why it should not decline jurisdiction. A response to the order to show cause was filed on October 16, 2015. On January 12, 2016, the Florida Supreme Court declined to accept jurisdiction of the case. The deadline to file a petition for writ of certiorari with the U.S. Supreme Court is April 11, 2016.

On February 29, 2012, in *Marotta v. R. J. Reynolds Tobacco Co*., a case filed in December 2007, in the Circuit Court, Broward County, Florida, the court declared a mistrial during jury prequalification. The plaintiff alleged that the decedent, Phil Marotta, was addicted to cigarettes and, as a result, suffered from lung cancer. The plaintiff sought an unspecified amount of compensatory and punitive damages, costs and pre-judgment interest. Retrial began on March 7, 2013. On March 20, 2013, a jury returned a verdict in favor of the plaintiff, found the decedent to be 42% at fault and RJR Tobacco to be 58% at fault, and awarded $6 million in compensatory damages and no punitive damages. Final judgment was entered against RJR Tobacco in the amount of $3.48 million, and RJR Tobacco filed a notice of appeal to the Fourth DCA in April 2013. The plaintiff filed a notice of cross appeal in May 2013. On January 6, 2016, the Fourth DCA affirmed the final judgment of the trial court. The deadline to file a notice to invoke the discretionary jurisdiction of the Florida Supreme Court is February 22, 2016.

On May 17, 2012, in *Calloway v. R. J. Reynolds Tobacco Co.,* a case filed in December 2007, in the Circuit Court, Broward County, Florida, a jury returned a verdict in favor of the plaintiff, found the decedent, Johnnie Calloway, to be 20.5% at fault, RJR Tobacco to be 27% at fault, Lorillard Tobacco to be 18% at fault, and the remaining defendants collectively to be 34.5% at fault, and awarded $20.5 million in compensatory damages and $17.25 million in punitive damages against RJR Tobacco, $12.6 million in punitive damages against Lorillard Tobacco, and $25 million collectively against the remaining defendants. The plaintiff alleged that as a result of using the defendants' products, the decedent became addicted and developed smoking-related diseases and/or conditions. The plaintiff sought an unspecified amount of compensatory and punitive damages, including costs and interest. In its ruling on the post-trial motions, the court determined that the jury's apportionment of comparative fault did not apply to the compensatory damages award. Final judgment was entered in August 2012. In September 2012, the defendants filed a notice of appeal to the Fourth DCA, RJR Tobacco posted a supersedeas bond in the amount of $1.5 million, and Lorillard Tobacco posted a supersedeas bond in the amount of $1.25 million. The plaintiff filed a notice of cross appeal. On January 6, 2016, the Fourth DCA reversed the fraudulent concealment and conspiracy claims, reversed the punitive damages award and remanded the case for a new trial on those issues. If the plaintiff chooses not to proceed with a new trial, the trial court will apply the smoker's percentage of comparative fault and reduce the compensatory damages award. The deadline to file a notice to invoke the discretionary jurisdiction of the Florida Supreme Court is February 22, 2016.

On August 1, 2012, in *Hiott v. R. J. Reynolds Tobacco Co*., a case filed in January 2008, in the Circuit Court, Duval County, Florida, a jury returned a verdict in favor of the plaintiff, found the decedent, Kenneth

Hiott, to be 60% at fault and RJR Tobacco to be 40% at fault, and awarded $1.83 million in compensatory damages and no punitive damages. The plaintiff alleged that as a result of using the defendant's product, the decedent suffered from addiction and smoking-related diseases and/or conditions. The plaintiff sought an unspecified amount of compensatory and punitive damages. In November 2012, final judgment was entered against RJR Tobacco in the amount of $730,000 in compensatory damages. RJR Tobacco filed a notice of appeal to the First DCA and posted a supersedeas bond in the amount of $730,000 in December 2012. In January 2014, the First DCA affirmed the trial court's decision. RJR Tobacco filed a notice to invoke the discretionary jurisdiction of the Florida Supreme Court in January 2014. In June 2014, the Florida Supreme Court stayed the petition pending the court's disposition of *Hess v. Philip Morris USA Inc.*, described above. On April 2, 2015, in *Hess*, the Florida Supreme Court held that, in *Engle* Progeny cases, the defendants cannot raise a statute of repose defense to claims for concealment or conspiracy. On February 2, 2016, the Florida Supreme Court declined to accept jurisdiction of the case. The deadline to file a petition for writ of certiorari with the U.S. Supreme Court is May 2, 2016.

On September 20, 2012, in *Sikes v. R. J. Reynolds Tobacco Co.*, a case filed in December 2007, in the Circuit Court, Duval County, Florida, a jury returned a verdict in favor of the plaintiff, found the decedent, Jimmie Sikes, to be 49% at fault and RJR Tobacco to be 51% at fault, and awarded $4.1 million in compensatory damages and $2 million in punitive damages. The plaintiff alleged that as a result of using the defendant's product, the decedent suffered from chronic obstructive pulmonary disease, and sought an unspecified amount of compensatory damages. Final judgment was entered against RJR Tobacco in the amount of $6.1 million on June 3, 2013. On June 25, 2013, the court entered a corrected final judgment against RJR Tobacco in the amount of $5.5 million and vacated the June 3, 2013 final judgment. RJR Tobacco filed a notice of appeal to the First DCA, and posted a supersedeas bond in the amount of $5 million in July 2013. In July 2014, the First DCA affirmed the trial court's decision, per curiam, but following the *Hiott* case, certified a conflict to the Florida Supreme Court with *Hess v. Philip Morris USA Inc.*, with both cases being described above. In August 2014, RJR Tobacco filed a notice to invoke the discretionary jurisdiction of the Florida Supreme Court. The Florida Supreme Court stayed the case pending disposition of *Hess v. Philip Morris USA Inc*. On April 2, 2015, in *Hess*, the Florida Supreme Court held that, in *Engle* Progeny cases, the defendants cannot raise a statute of repose defense to claims for concealment or conspiracy. On February 2, 2016, the Florida Supreme Court declined to accept jurisdiction of the case. The deadline to file a petition for writ of certiorari with the U.S. Supreme Court is May 2, 2016.

On October 17, 2012, in *James Smith v. R. J. Reynolds Tobacco Co.*, a case filed in August 2007, in the U.S. District Court for the Middle District of Florida, a jury returned a verdict in favor of the plaintiff, found the decedent, Wanette Smith, to be 45% at fault and RJR Tobacco to be 55% at fault, and awarded $600,000 in compensatory damages and $20,000 in punitive damages. The plaintiff alleged that as a result of using the defendant's products, the decedent suffered from lung cancer and chronic obstructive pulmonary disease. The plaintiff sought an unspecified amount of compensatory and punitive damages, costs and interest. Final judgment was entered against RJR Tobacco in the amount of $620,000. RJR Tobacco filed a notice of appeal to the Eleventh Circuit and posted a supersedeas bond in the amount of approximately $620,000 in September 2013. Oral argument occurred on October 17, 2014. A decision is pending.

On October 19, 2012, in *Ballard v. R. J. Reynolds Tobacco Co.*, a case filed in September 2007, in the Circuit Court, Miami-Dade County, Florida, a jury returned a verdict in favor of the plaintiff, found the plaintiff to be 45% at fault and RJR Tobacco to be 55% at fault, and awarded $8.55 million in compensatory damages. Punitive damages were not at issue. The plaintiff alleged that as a result of using the defendant's products, he suffers from bladder cancer and emphysema, and sought an unspecified amount of compensatory and punitive damages. The court entered final judgment against RJR Tobacco in the amount of $4.7 million in October 2012, and in August 2013, the court entered an amended final judgment against RJR Tobacco in the amount of $5 million. RJR Tobacco filed a notice of appeal to the Third DCA and posted a supersedeas bond in the amount of $5 million in October 2013. In March 2015, the Third DCA affirmed the amended final judgment. RJR Tobacco's motion for rehearing and rehearing en banc was denied on April 30, 2015. On May 29, 2015, RJR Tobacco filed a notice to invoke the discretionary jurisdiction of the Florida Supreme Court. On September 24, 2015, the Florida Supreme Court declined to accept jurisdiction. The deadline to file a petition for writ of certiorari with the U.S. Supreme Court is February 19, 2016.

On February 11, 2013, in *Evers v. R. J. Reynolds Tobacco Co.*, a case filed in November 2007, in the Circuit Court, Hillsborough County, Florida, a jury returned a verdict in favor of the plaintiff, found the decedent, Jacqueline Loyd, to be 31% at fault, RJR Tobacco to be 60% at fault and Lorillard Tobacco to be 9% at fault, and awarded $3.23 million in compensatory damages and $12.36 million in punitive damages against RJR Tobacco

only. The plaintiff alleged that as a result of using the defendants' products, the decedent became addicted and suffered from smoking-related diseases and/or conditions, and sought an unspecified amount of damages. In March 2013, the court granted the defendants' post-trial motions for directed verdict on fraudulent concealment, conspiracy and punitive damages. As a result, the $12.36 million punitive damages award was set aside. The plaintiff's motion to reconsider directed verdict as to concealment, conspiracy and punitive damages was denied in April 2013. Final judgment was entered in the amount of $1.77 million against RJR Tobacco and approximately $266,000 against Lorillard Tobacco. The plaintiff filed a notice of appeal to the Second DCA, the defendants filed a notice of cross appeal, RJR Tobacco posted a supersedeas bond in the amount of $1.77 million and Lorillard Tobacco posted a supersedeas bond in the amount of approximately $266,000 in May 2013. On November 6, 2015, the Second DCA concluded that the trial court erred in granting the defendants' motion for directed verdict on claims for fraud by concealment and conspiracy to commit fraud by concealment, and reversed and reinstated the jury's verdict on those two claims. As a result, the punitive damages award was reinstated, subject to reconsideration of open issues on remand.

On February 13, 2013, in *Schoeff v. R. J. Reynolds Tobacco Co*., a case filed in November 2007, in the Circuit Court, Broward County, Florida, a jury returned a verdict in favor of the plaintiff, found the decedent, James Schoeff, to be 25% at fault, RJR Tobacco to be 75% at fault, and awarded $10.5 million in compensatory damages and $30 million in punitive damages. The plaintiff alleged that as a result of using the defendant's products, the decedent suffered from addiction and one or more smoking-related diseases and/or conditions, including lung cancer, and sought an unspecified amount of damages. In April 2013, final judgment was entered against RJR Tobacco in the amount of $7.88 million in compensatory damages and $30 million in punitive damages. RJR Tobacco filed a notice of appeal to the Fourth DCA, and the plaintiff filed a notice of cross appeal in May 2013. On November 4, 2015, the Fourth DCA reversed the punitive damages portion of the final judgment and remanded the case to the trial court. The trial court was directed to grant RJR Tobacco's motion for remittitur and, if RJR Tobacco does not agree with the remitted amount, to hold a new trial on punitive damages. On December 2, 2015, the plaintiff filed a notice to invoke the discretionary jurisdiction of the Florida Supreme Court.

On April 1, 2013, in *Searcy v. R. J. Reynolds Tobacco Co*., a case filed in January 2008, in the U.S. District Court for the Middle District of Florida, a jury returned a verdict in favor of the plaintiff, found the decedent, Carol LaSard, to be 40% at fault, RJR Tobacco to be 30% at fault and the remaining defendant to be 30% at fault, and awarded $6 million in compensatory damages and $10 million in punitive damages against each defendant. The plaintiff alleged that as a result of using the defendants' products, the decedent suffered from lung cancer, and sought an unspecified amount of compensatory and punitive damages. Final judgment was entered against RJR Tobacco in the amount of $6 million in compensatory damages and $10 million in punitive damages. In September 2013, the trial court granted the defendants' motion for a new trial, or in the alternative, reduction or remittitur of the damages awarded to the extent it sought remittitur of the damages. The compensatory damage award was remitted to $1 million, and the punitive damage award was remitted to $1.67 million against each defendant. The remaining post-trial motions were denied. The plaintiff's motion to reconsider the trial court's order granting in part the defendants' motion for remittitur of the damages award was denied in October 2013. The plaintiff filed a notice of acceptance of remittitur in November 2013, and the court issued an amended final judgment. The defendants filed a joint notice of appeal to the Eleventh Circuit, and RJR Tobacco posted a supersedeas bond in the amount of approximately $2.2 million in November 2013. Oral argument occurred on October 17, 2014. A decision is pending.

On May 2, 2013, in *David Cohen v. R. J. Reynolds Tobacco Co.*, a case filed in December 2007, in the Circuit Court, Palm Beach County, Florida, a jury returned a verdict in favor of the plaintiff, found the decedent, Helen Cohen, to be 40% at fault, RJR Tobacco to be 30% at fault, Lorillard Tobacco to be 20% at fault and the remaining defendant to be 10% at fault, and awarded $2.06 million in compensatory damages. The plaintiff alleged that as a result of using the defendants' products, the decedent became addicted and suffered from one or more smoking-related diseases and/or conditions, and sought an unspecified amount of compensatory and punitive damages. Final judgment was entered against RJR Tobacco in the amount of $617,000 and against Lorillard Tobacco in the amount of approximately $411,000 in May 2013. In July 2013, the court granted the defendants' motion for a new trial due to the plaintiff's improper arguments during closing. The new trial date has not been scheduled. The plaintiff filed a notice of appeal to the Fourth DCA, and the defendants filed a notice of cross appeal. Briefing is underway.

On May 23, 2013, in *Earl Graham v. R. J. Reynolds Tobacco Co.*, a case filed in January 2008, in the U.S. District Court for the Middle District of Florida, a jury returned a verdict in favor of the plaintiff, found the decedent, Faye Graham, to be 70% at fault, RJR Tobacco to be 20% at fault and the remaining defendant to be

10% at fault, and awarded $2.75 million in compensatory damages. The plaintiff alleged that as a result of smoking the defendants' products, the decedent became addicted, which resulted in her death, and sought an unspecified amount of damages. Final judgment was entered against RJR Tobacco in the amount of $550,000 in May 2013. The defendants filed a joint notice of appeal to the Eleventh Circuit, and RJR Tobacco posted a supersedeas bond in the amount of approximately $556,000 in October 2013. On April 8, 2015, the Eleventh Circuit reversed and ordered entry of judgment for RJR Tobacco. The Eleventh Circuit held that federal law impliedly preempts claims for strict liability and negligence based on the defect and negligence findings from *Engle*. On January 21, 2016, the plaintiff's motion for rehearing *en banc* was granted. A briefing schedule has not been entered.

On June 4, 2013, in *Starr-Blundell v. R. J. Reynolds Tobacco Co.*, a case filed in December 2007, in the Circuit Court, Duval County, Florida, a jury returned a verdict in favor of the plaintiff, found the decedent, Lucy Mae Starr, to be 80% at fault, RJR Tobacco to be 10% at fault and the remaining defendant to be 10% at fault, and awarded $500,000 in compensatory damages. The plaintiff alleged that as a result of smoking the defendants' products, the decedent suffered from lung cancer and other smoking-related diseases and/or conditions, and sought an unspecified amount of damages. The court entered final judgment in the amount of $50,000 against each defendant in November 2013. The plaintiff filed a notice of appeal to the First DCA, and the defendants filed a notice of cross appeal in December 2013. RJR Tobacco posted a supersedeas bond in the amount of $50,000 in December 2013. On May 29, 2015, the First DCA affirmed the final judgment of the trial court, per curiam. On June 29, 2015, the plaintiff filed a notice to invoke the discretionary jurisdiction of the Florida Supreme Court. On July 7, 2015, the Florida Supreme Court stayed the petition pending disposition of *Soffer v. R. J. Reynolds Tobacco Co.*, described above.

On June 14, 2013, in *Skolnick v. R. J. Reynolds Tobacco Co.*, a case filed in December 2007, in the Circuit Court, Palm Beach County, Florida, a jury returned a verdict in favor of the plaintiff, found the decedent, Leo Skolnick, to be 40% at fault, RJR Tobacco to be 30% at fault and the remaining defendant to be 30% at fault, and awarded $2.56 million in compensatory damages. The plaintiff alleged that as a result of using the defendants' products, the decedent suffered from lung cancer, and sought an unspecified amount of compensatory and punitive damages. The court entered final judgment against RJR Tobacco in the amount of $766,500 in July 2013. The defendants filed a joint notice of appeal to the Fourth DCA, and the plaintiff filed a notice of cross appeal in December 2013. RJR Tobacco posted a supersedeas bond in the amount of $767,000 in March 2014. On July 15, 2015, the Fourth DCA set aside the judgment and ordered a partial new trial. The court held that the strict liability and negligence claims, on which the plaintiff had prevailed, were barred by a prior settlement entered into by the plaintiff in a separate action. However, the court also held that the plaintiff's concealment and conspiracy claims, on which the defendants had prevailed, must be re-tried due to an erroneous jury instruction on the statute of repose. The new trial has not been scheduled.

On June 19, 2013, in *Thibault v. R. J. Reynolds Tobacco Co.*, a case pending in the Circuit Court, Escambia County, Florida, a jury returned a verdict in favor of the plaintiff, found the decedent, Evelyn Thibault, to be 30% at fault and RJR Tobacco to be 70% at fault, and awarded $1.75 million in compensatory damages and $1.28 million in punitive damages. The plaintiff alleged that as a result of using the defendant's products, the decedent suffered from chronic obstructive pulmonary disease, and sought an unspecified amount of compensatory and punitive damages. The court determined that comparative fault did not apply to reduce the amount of the verdict. In June 2013, the court entered final judgment against RJR Tobacco in the amount of $3.03 million. RJR Tobacco filed a notice of appeal to the First DCA in August 2013. RJR Tobacco posted a supersedeas bond in the amount of $3.03 million in September 2013. On October 13, 2014, the First DCA affirmed the trial court's judgment, per curiam. The First DCA also certified a conflict to the Florida Supreme Court with *Hess v. Philip Morris USA, Inc.*, described above. On October 22, 2014, RJR Tobacco filed a notice to invoke the discretionary jurisdiction of the Florida Supreme Court. The Florida Supreme Court stayed the case pending disposition of *Hess v. Philip Morris USA Inc.* On April 2, 2015, in *Hess*, the Florida Supreme Court held that, in *Engle* Progeny cases, the defendants cannot raise a statute of repose defense to claims for concealment or conspiracy. On February 2, 2016, the Florida Supreme Court declined to accept jurisdiction of the case. The deadline to file a petition for writ of certiorari with the U.S. Supreme Court is May 2, 2016.

On September 20, 2013, in *Gafney v. R. J. Reynolds Tobacco Co.*, a case pending in Palm Beach County, Florida, a jury returned a verdict in favor of the plaintiff, found the decedent, Frank Gafney, to be 34% at fault, RJR Tobacco to be 33% at fault and Lorillard Tobacco to be 33% at fault, and awarded $5.8 million in compensatory damages. Punitive damages were not awarded. The plaintiff alleged that as a result of smoking the defendants' products, the decedent developed chronic obstructive pulmonary disease, and sought an unspecified amount of compensatory damages. Final judgment was entered against RJR Tobacco in the amount of

$1.9 million and Lorillard Tobacco in the amount of $1.9 million in September 2013. The defendants filed a joint notice of appeal to the Fourth DCA, and RJR Tobacco and Lorillard Tobacco each posted supersedeas bonds in the amount of $1.9 million in November 2013. The plaintiff filed a notice of cross appeal. Oral argument occurred on January 12, 2016. A decision is pending.

On January 27, 2014, in *Harford v. R. J. Reynolds Tobacco Co.*, a case filed in January 2008, in the U.S. District Court for the Middle District of Florida, a jury returned a verdict in favor of the plaintiff, found the plaintiff to be 82% at fault and RJR Tobacco to be 18% at fault, and awarded $330,000 in compensatory damages. The plaintiff alleged that as a result of his use of the defendant's products, he suffers from addiction and lung cancer, and sought an unspecified amount of compensatory and punitive damages. The court granted the plaintiff's motion for a new trial on compensatory damages in October 2014. This case was resolved as part of the federal *Engle* Progeny settlement. A dismissal with prejudice was filed on December 9, 2015.

On January 31, 2014, in *Cheeley v. R. J. Reynolds Tobacco Co.*, a case filed in November 2007, in the Circuit Court, Broward County, Florida, a jury returned a verdict in favor of the plaintiff, found the decedent, Georgia Cheeley, to be 50% at fault and RJR Tobacco to be 50% at fault, and awarded $3 million in compensatory damages and $2 million in punitive damages. The plaintiff alleged that as a result of smoking the defendant's products, the decedent suffered from one or more smoking-related conditions or diseases, and sought an unspecified amount of compensatory damages. The court entered final judgment against RJR Tobacco in the amount of $1.5 million in compensatory damages and $2 million in punitive damages. RJR Tobacco filed a notice of appeal to the Fourth DCA and posted a supersedeas bond in the amount of $3.5 million in April 2014. The plaintiff filed a notice of cross appeal in May 2014. Oral argument occurred on January 12, 2016. On January 28, 2016, the Fourth DCA affirmed the judgment of the trial court, per curiam. The deadline to file a motion for rehearing, clarification, motion for written opinion, motion for certification to the Florida Supreme Court or motion for rehearing *en banc* is February 12, 2016. The deadline to file a notice to invoke the discretionary jurisdiction of the Florida Supreme Court is March 16, 2016.

On February 3, 2014, in *Deshaies v. R. J. Reynolds Tobacco Co.*, a case filed in January 2008, in the U.S. District Court for the Middle District of Florida, a jury returned a verdict in favor of RJR Tobacco. The plaintiff alleged that as a result of smoking the defendant's products, he suffers from one or more smoking-related conditions or diseases, and sought an unspecified amount of compensatory and punitive damages. Final judgment was entered in February 2014. The plaintiff filed a notice of appeal to the Eleventh Circuit on February 11, 2015. Briefing is underway.

On February 27, 2014, in *Banks v. R. J. Reynolds Tobacco Co.*, a case filed in December 2007, in the Circuit Court, Broward County, Florida, a jury returned a verdict in favor of the defendants, including RJR Tobacco. The plaintiff alleged that as a result of using the defendants' products, the decedent, George Banks, developed one or more smoking-related diseases and/or conditions, and sought an unspecified amount of compensatory damages. The plaintiff's motion for a new trial was denied, and the court entered final judgment in favor of RJR Tobacco and the other defendant in May 2014. The plaintiff filed a notice of appeal to the Fourth DCA, and the defendants filed a notice of cross appeal in June 2014. Briefing is underway.

On March 17, 2014, in *Clayton v. R. J. Reynolds Tobacco Co.*, a case filed in November 2007, in the Circuit Court, Duval County, Florida, a jury returned a verdict in favor of the plaintiff, found the decedent, David Clayton, to be 90% at fault and RJR Tobacco to be 10% at fault, and awarded $600,000 in compensatory damages. Punitive damages were not awarded. The plaintiff alleged that as a result of smoking the defendant's products, the decedent suffered from bodily injury and died, and sought an unspecified amount of damages. In July 2014, final judgment was entered against RJR Tobacco in the amount of $60,000 in compensatory damages, together with $163,469 in taxable costs, for a total of $223,469. RJR Tobacco filed a notice of appeal to the First DCA in August 2014. RJR Tobacco posted a supersedeas bond in the amount of approximately $223,000, and the plaintiff filed a notice of cross appeal in September 2014. On October 26, 2015, the First DCA affirmed the final judgment, per curiam. On November 25, 2015, the plaintiff filed a notice to invoke the discretionary jurisdiction of the Florida Supreme Court. The Florida Supreme Court stayed proceedings pending disposition of *Soffer v. R. J. Reynolds Tobacco Co.*, described above.

On March 26, 2014, in *Bowden v. R. J. Reynolds Tobacco Co.*, a case filed in January 2008, in the Circuit Court, Duval County, Florida, a jury returned a verdict in favor of the plaintiff, found the decedent, William Bowden, to be 40% at fault, RJR Tobacco to be 30% at fault and the remaining defendant to be 30% at fault, and awarded $5 million in compensatory damages. Punitive damages were not awarded. The plaintiff alleged that as a result of smoking the defendants' products, the decedent suffered from unspecified injuries which resulted in his death, and sought an unspecified amount of compensatory and punitive damages. Final judgment was entered

against each defendant in the amount of $1.5 million in compensatory damages in March 2014. The defendants filed a joint notice of appeal to the First DCA, the plaintiff filed a notice of cross appeal and RJR Tobacco posted a supersedeas bond in the amount of $1.5 million in June 2014. On February 2, 2016, the First DCA affirmed the judgment of the trial court, per curiam. The deadline to file a motion for rehearing is February 17, 2016.

On May 16, 2014, in *Burkhart v. R. J. Reynolds Tobacco Co.*, a case filed in January 2008, in the U.S. District Court for the Middle District of Florida, a jury returned a verdict in favor of the plaintiff, found the plaintiff to be 50% at fault, RJR Tobacco to be 25% at fault, Lorillard Tobacco to be 10% at fault and the remaining defendant to be 15% at fault, and awarded $5 million in compensatory damages and $1.25 million in punitive damages against RJR Tobacco, $500,000 in punitive damages against Lorillard Tobacco and $750,000 in punitive damages against the remaining defendant. The plaintiff alleged that she became addicted to smoking cigarettes manufactured by the defendants and suffers from one or more smoking-related diseases and/or conditions. The plaintiff sought an unspecified amount of compensatory and punitive damages, costs and interest. Final judgment was entered in June 2014, and did not include a reduction for comparative fault. In September 2014, the court denied the defendants' post-trial motions. The defendants filed a joint notice of appeal to the Eleventh Circuit on October 10, 2014. Oral argument occurred on September 29, 2015. A decision is pending.

On May 19, 2014, in *Starbuck v. R. J. Reynolds Tobacco Co.*, a case filed in January 2008, in the U.S. District Court for the Middle District of Florida, the court declared a mistrial because the jury was unable to reach a unanimous verdict. The plaintiff alleged that he suffers from addiction and one or more smoking-related diseases and/or conditions. The plaintiff is seeking an unspecified amount of compensatory damages. Retrial began on December 1, 2014, and on December 16, 2014, the jury returned a verdict in favor of the defendants, including RJR Tobacco. Final judgment was entered in February 2015. In May 2015, the plaintiff's motion for a new trial was granted on the grounds that the jury's verdict on "addiction" was against the greater weight of the evidence. The new trial has not been scheduled.

On June 23, 2014, in *Bakst v. R. J. Reynolds Tobacco Co.*, now known as *Odom v. R. J. Reynolds Tobacco Co.*, a case filed in December 2007, in the Circuit Court, Palm Beach County, Florida, a jury returned a verdict in favor of the plaintiff, found the decedent, Juanita Thurston, to be 25% at fault and RJR Tobacco to be 75% at fault, and awarded $6 million in compensatory damages plus $4,209 for funeral expenses and $14 million in punitive damages. The plaintiff alleged that as a result of using the defendant's products, the decedent suffered from nicotine addiction and one or more smoking-related diseases and/or conditions, including lung cancer. The plaintiff sought an unspecified amount of compensatory and punitive damages, recoverable costs and interest. RJR Tobacco's post-trial motions were denied, and final judgment was entered against RJR Tobacco in the amount of $4.5 million in compensatory damages and $14 million in punitive damages. RJR Tobacco filed a notice of appeal to the Fourth DCA and posted a supersedeas bond in the amount of $5 million in October 2014. Briefing is complete. Oral argument has not been scheduled.

On July 17, 2014, in *Robinson v. R. J. Reynolds Tobacco Co.*, a case filed in January 2008, in the Circuit Court, Escambia County, Florida, a jury returned a verdict in favor of the plaintiff, found the decedent, Michael Johnson, Sr., to be 29.5% at fault and RJR Tobacco to be 70.5% at fault, and awarded $16.9 million in compensatory damages and determined that the plaintiff was entitled to punitive damages. On July 18, 2014, the jury awarded $23.6 billion in punitive damages. The plaintiff alleged that as a result of using the defendant's products, the decedent suffered from lung cancer. The plaintiff sought an unspecified amount of damages, costs and interest. The court entered partial judgment on compensatory damages against RJR Tobacco in the amount of $16.9 million in July 2014. On January 27, 2015, the court denied the defendant's post-trial motions, but granted the defendant's motion for remittitur of the punitive damages award. The punitive damages award was remitted to approximately $16.9 million. In February 2015, RJR Tobacco filed an objection to the remitted award of punitive damages and a demand for a new trial on damages. The court granted a new trial on the amount of punitive damages only. The new trial on punitive damages, which was scheduled for June 29, 2015, has been stayed. RJR Tobacco filed a notice of appeal to the First DCA of the partial judgment of compensatory damages and of the order granting a new trial on the amount of punitive damages only, and posted a supersedeas bond in the amount of $5 million. Briefing on the merits is ongoing.

On July 31, 2014, in *Harris v. R. J. Reynolds Tobacco Co.*, a case filed in January 2008, in the U.S. District Court for the Middle District of Florida, a jury returned a verdict in favor of the plaintiff. The jury allocated fault: (1) for the survival claim as follows: decedent — 60%, RJR Tobacco — 15%, Lorillard — 10%, and the remaining defendant — 15%, and (2) for the wrongful death claim as follows: decedent — 70%, RJR Tobacco — 10%, Lorillard — 10%, and the remaining defendant — 10%. The jury awarded $400,000 in compensatory damages for wrongful death and $1.3 million in compensatory damages for the survival claim. The jury declined to award punitive damages. The plaintiff alleged that as a result of smoking cigarettes manufactured by the

defendants, the decedent, Gerald Harris, became addicted and suffered from unspecified smoking-related diseases and/or conditions. The plaintiff sought an unspecified amount of compensatory damages, costs and interest. Final judgment was entered in December 2014. Post-trial motions are pending. In April 2015, the court stayed all post-trial proceedings pending resolution of the petition for *en banc* consideration in *Graham v. R. J. Reynolds Tobacco Co.*, discussed above.

On August 27, 2014, in *Gore v. R. J. Reynolds Tobacco Co.*, a case filed in January 2008, in the Circuit Court, Indian River County, Florida, the court declared a mistrial because the jury returned a potentially inconsistent verdict. The jury found for the plaintiff on liability, but awarded no compensatory damages and determined that the plaintiff was entitled to punitive damages. The plaintiff alleged that as a result of using the defendants' products, the decedent, Gloria Gore, suffered from addiction and one or more smoking-related diseases and/or conditions. The plaintiff sought an unspecified amount of damages. Retrial began on March 9, 2015. On March 26, 2015, the jury returned a verdict in favor of the plaintiff, found the decedent 54% at fault, RJR Tobacco 23% at fault and the remaining defendant 23% at fault, and awarded $2 million in compensatory damages. Punitive damages were not awarded. Post-trial motions were denied, and final judgment was entered against RJR Tobacco and the remaining defendant each in the amount of $460,000 in September 2015. RJR Tobacco posted a supersedeas bond in the amount of $460,000 in September 2015, and in October 2015, the defendants filed a joint notice of appeal, and the plaintiff filed a notice of cross appeal to the Fourth DCA. Briefing is underway.

On August 28, 2014, in *Wilcox v. R. J. Reynolds Tobacco Co.*, a case filed in January 2008, in the Circuit Court, Miami-Dade County, Florida, a jury returned a verdict in favor of the plaintiff, found the decedent, Cleston Wilcox, to be 30% at fault and RJR Tobacco to be 70% at fault, and awarded $7 million in compensatory damages and $8.5 million in punitive damages. The plaintiff alleged that as a result of using the defendant's products, the decedent suffered from addiction and one or more smoking-related diseases and/or conditions. The plaintiff sought an unspecified amount of damages, taxable costs and interest. Final judgment was entered in September 2014 against RJR Tobacco in the amount of $4.9 million in compensatory damages and $8.5 million in punitive damages. RJR Tobacco filed a notice of appeal to the Third DCA and posted a supersedeas bond in the amount of $5 million in February 2015. Briefing is complete. Oral argument has not been scheduled.

On August 28, 2014, in *Irimi v. R. J. Reynolds Tobacco Co.*, a case filed in December 2007, in the Circuit Court, Broward County, Florida, a jury returned a verdict in favor of the plaintiff, found the decedent, Dale Moyer, to be 70% at fault, RJR Tobacco to be 14.5% at fault, Lorillard Tobacco to be 14.5% at fault and the remaining defendant to be 1% at fault, and awarded approximately $3.1 million in compensatory damages. The jury did not find entitlement to punitive damages. The plaintiff alleged that as a result of using the defendants' products, the decedent suffered from one or more smoking-related illnesses or diseases. The plaintiff sought an unspecified amount of compensatory damages. Final judgment was entered against each of RJR Tobacco and Lorillard Tobacco in the amount of approximately $453,000 and against the remaining defendant in the amount of approximately $31,000. On January 29, 2015, the court granted the defendants' motion for a new trial. The new trial has not been scheduled. The plaintiff filed a notice of appeal to the Fourth DCA in February 2015, and the defendants filed a notice of cross appeal in March 2015. Briefing is underway.

On August 29, 2014, in *Hubbird v. R. J. Reynolds Tobacco Co.*, a case filed in January 2008, in the Circuit Court, Miami-Dade County, Florida, a jury returned a verdict in favor of the plaintiff, found the decedent, David Ellsworth, to be 50% at fault and RJR Tobacco to be 50% at fault, and awarded $3 million in compensatory damages and $25 million in punitive damages. The plaintiff alleged that as a result of using the defendant's products, the decedent suffered from smoking-related diseases and/or conditions. The plaintiff sought an unspecified amount of damages. Final judgment was entered against RJR Tobacco in the amount of $28 million. RJR Tobacco filed a notice of appeal to the Third DCA and posted a supersedeas bond in the amount of $5 million in December 2014. Briefing is complete. Oral argument has not been scheduled.

On October 10, 2014, in *Lourie v. R. J. Reynolds Tobacco Co.*, a case filed in December 2007, in the Circuit Court, Hillsborough County, Florida, a jury returned a verdict in favor of the plaintiff, found the decedent, Barbara Lourie, to be 63% at fault, RJR Tobacco to be 3% at fault, Lorillard Tobacco to be 7% at fault and the remaining defendant to be 27% at fault, and awarded approximately $1.37 million in compensatory damages. Punitive damages were not awarded. The plaintiff alleged that as a result of using the defendants' products, the decedent suffered from addiction and one or more smoking-related diseases and/or conditions. The plaintiff sought an unspecified amount of compensatory and punitive damages, costs and interest. Post-trial motions were denied, final judgment was entered, and the defendants filed a joint notice of appeal to the Second DCA in November 2014. RJR Tobacco posted a supersedeas bond in the amount of approximately $41,000, and Lorillard Tobacco posted a supersedeas bond in the amount of $96,000. Briefing is complete. Oral argument is scheduled for March 16, 2016.

On October 22, 2014, in *Kerrivan v. R. J. Reynolds Tobacco Co.*, a case filed in January 2008, in the U.S. District Court for the Middle District of Florida, a jury returned a verdict in favor of the plaintiff, found the plaintiff to be 19% at fault, RJR Tobacco to be 31% at fault and the remaining defendant to be 50% at fault, and awarded $15.8 million in compensatory damages, and $9.6 million in punitive damages against RJR Tobacco and $15.7 million against the remaining defendant. The plaintiff alleged that as a result of using the defendants' products, the plaintiff developed one or more smoking-related diseases and/or conditions. The plaintiff sought an unspecified amount of compensatory damages, punitive damages, costs and interest. Final judgment was entered in November 2014. RJR Tobacco filed its post-trial motions on December 11, 2014. In May 2015, the trial court deferred briefing and directed the parties to notify the court when the mandate has been issued in *Graham v. R. J. Reynolds Tobacco Co.* or *Searcy v. R. J. Reynolds Tobacco Co.*, described above.

On November 5, 2014, in *Bishop v. R. J. Reynolds Tobacco Co.*, a case filed in December 2007, in the Circuit Court, Orange County, Florida, a jury returned a verdict in favor of the defendants, including RJR Tobacco. The plaintiff alleged that as a result of using the defendants' products, the decedent, Robert Ramsay, suffered from one or more smoking-related diseases and/or conditions. The plaintiff sought an unspecified amount of compensatory and punitive damages, costs and interest. Final judgment was entered in November 2014. The plaintiff's motion for a new trial was denied in December 2014. In January 2015, the plaintiff filed a notice of appeal, and the defendants filed a notice of cross appeal to the Fifth DCA. Briefing is underway.

On November 7, 2014, in *Taylor v. R. J. Reynolds Tobacco Co.*, a case filed in December 2007, in the Circuit Court, Duval County, Florida, a jury returned a verdict in favor of the plaintiff, found the plaintiff to be 42% at fault and RJR Tobacco to be 58% at fault, and awarded approximately $4.5 million in compensatory damages and approximately $521,000 in punitive damages. The plaintiff alleged that as a result of using the defendant's products, she suffers from chronic obstructive pulmonary disease and peripheral vascular disease. The plaintiff sought an unspecified amount of compensatory damages. Post-trial motions were denied, and final judgment was entered in the amount of approximately $4.64 million against RJR Tobacco in November 2014. RJR Tobacco filed a notice of appeal to the First DCA and posted a supersedeas bond in the amount of approximately $4.64 million in December 2014. Oral argument occurred on October 14, 2015. On October 20, 2015, the First DCA affirmed the judgment of the trial court, per curiam. RJR Tobacco paid approximately $4.9 million in satisfaction of the judgment on January 19, 2016.

On November 18, 2014, in *Schleider v. R. J. Reynolds Tobacco Co.*, a case filed in January 2008, in the Circuit Court, Miami-Dade County, Florida, a jury returned a verdict in favor of the plaintiff, found the decedent, Andrew Schleider, to be 30% at fault and RJR Tobacco to be 70% at fault, and awarded $21 million in compensatory damages. The plaintiff alleged that as a result of the use of the defendant's products, the decedent suffered from lung cancer and one or more smoking-related diseases and/or conditions. The plaintiff sought an unspecified amount of damages plus taxable costs and interest. In June 2015, post-trial motions were denied, and final judgment was entered against RJR Tobacco in the amount of $14.7 million. RJR Tobacco filed a notice of appeal to the Third DCA and posted a supersedeas bond in the amount of $5 million on July 16, 2015. On September 1, 2015, RJR Tobacco filed a motion to stay the appeal pending the decision by the Florida Supreme Court in *Ciccone v. R. J. Reynolds Tobacco Co.*, described above. The motion was granted on September 21, 2015.

On November 21, 2014, in *Perrotto v. R. J. Reynolds Tobacco Co.*, a case filed in December 2007, in the Circuit Court, Palm Beach County, Florida, a jury returned a verdict in favor of the plaintiff, found the decedent, Nicholas Perrotto, to be 49% at fault, RJR Tobacco to be 20% at fault, Lorillard Tobacco to be 6% at fault and the remaining defendant to be 25% at fault, and awarded approximately $4.1 million in compensatory damages. Punitive damages were not awarded. The plaintiff alleged that as the result of the use of the defendants' products, the decedent suffered from one or more smoking-related diseases and/or conditions. The plaintiff sought an unspecified amount of damages, taxable costs and recoverable interest. Final judgment was entered against RJR Tobacco in the amount of approximately $818,000 and against Lorillard Tobacco in the amount of approximately $245,000, and in December 2014, the plaintiff and the defendants filed motions for a new trial. Decisions are pending.

On December 19, 2014, in *Haliburton v. R. J. Reynolds Tobacco Co.*, a case filed in January 2008, in the Circuit Court, Palm Beach County, Florida, a jury returned a verdict in favor of RJR Tobacco. The plaintiff alleged that as the result of the use of the defendant's products, the decedent, Andrew Haliburton, suffered from one or more smoking-related diseases and/or conditions. The plaintiff sought an unspecified amount of compensatory and punitive damages, costs and interest. Final judgment was entered in favor of RJR Tobacco on April 14, 2015. In May 2015, the plaintiff filed a notice of appeal to the Fourth DCA, and RJR Tobacco filed a notice of cross appeal. Briefing is underway.

On January 29, 2015, in *Ellen Gray v. R. J. Reynolds Tobacco Co.*, a case filed in January 2008, in the U.S. District Court for the Middle District of Florida, a jury returned a verdict in favor of the plaintiff, found the decedent, Henry Gray, to be 50% at fault and RJR Tobacco to be 50% at fault, and awarded $6 million in compensatory damages. Punitive damages were not awarded. The plaintiff alleged that as a result of the use of the defendant's products, the decedent suffered from lung cancer, chronic obstructive pulmonary disease and other smoking-related diseases and/or conditions. The plaintiff sought an unspecified amount of compensatory and punitive damages, costs and interest. Final judgment was entered against RJR Tobacco in the amount of $3 million in February 2015. Post-trial motions are pending. On June 10, 2015, the court granted RJR Tobacco's motion to stay the case pending resolution of the petition for *en banc* consideration in *Graham v. R. J. Reynolds Tobacco Co.*, described above.

On February 10, 2015, in *Hecht v. R. J. Reynolds Tobacco Co*., a case filed in January 2008, in the U.S. District Court for the Middle District of Florida, a jury returned a verdict in favor of RJR Tobacco. The plaintiff alleged that as a result of the use of the defendant's products, he suffers from chronic obstructive pulmonary disease and coronary heart disease. The plaintiff sought an unspecified amount of compensatory and punitive damages, costs and interest. Post-trial proceedings have been stayed until resolution of the petition for *en banc* consideration in *Graham v. R. J. Reynolds Tobacco Co.*, described above. However, the court entered final judgment in favor of RJR Tobacco on January 7, 2016.

On February 11, 2015, in *Sowers v. R. J. Reynolds Tobacco Co.*, a case filed in January 2008, in the U.S. District Court for the Middle District of Florida, a jury returned a verdict in favor of the plaintiff, found the decedent, Charles Sowers, to be 50% at fault and RJR Tobacco to be 50% at fault, and awarded $4.25 million in compensatory damages. Punitive damages were not awarded. The plaintiff alleged that as a result of using the defendant's products, the decedent suffered from lung cancer and chronic obstructive pulmonary disease. The plaintiff sought an unspecified amount of compensatory and punitive damages, costs and interest. Final judgment was entered against RJR Tobacco in the amount of approximately $2.13 million on February 12, 2015. Post-trial motions are pending. On April 17, 2015, the court stayed post-trial proceedings until resolution of the petition for *en banc* consideration in *Graham v. R. J. Reynolds Tobacco Co*., described above.

On February 24, 2015, in *Caprio v. R. J. Reynolds Tobacco Co*., a jury advised the court that it could not reach a unanimous verdict. The court directed the jury to complete the verdict form on those individual verdict questions where there was unanimous agreement. The jury did not reach unanimous agreement on all questions and completed only part of the verdict form. The defendants moved for a mistrial, and the plaintiff moved for entry of a partial verdict. The Court requested post-trial briefing. In May 2015, the court advised that it accepted the questions answered by the jurors as a partial verdict. The court also denied the defendants' post-trial motions. A new trial will be held on the remaining issues, including comparative fault allocation. The defendants filed a notice of appeal to the Fourth DCA on May 26, 2015, and briefing is underway. The plaintiff filed a motion to dismiss the appeal on June 16, 2015. A decision on that motion is pending.

On February 26, 2015, in *Zamboni v. R. J. Reynolds Tobacco Co.*, a case filed in January 2008, in the U.S. District Court for the Middle District of Florida, a jury returned a verdict in favor of the plaintiff, found the decedent, Robert Hoover, to be 60% at fault, RJR Tobacco to be 30% at fault and the remaining defendant to be 10% at fault, and awarded $340,000 in compensatory damages. Punitive damages were not awarded. The plaintiff alleged that as a result of the use of the defendants' products, the decedent suffered from cerebrovascular disease, coronary heart disease and lung cancer. The plaintiff sought an unspecified amount of compensatory and punitive damages, costs and interest. Post-trial motions are pending. The court stayed the case pending resolution of the petition for *en banc* consideration in *Graham v. R. J. Reynolds Tobacco Co.*, discussed above.

On March 18, 2015, in *Dion v. R. J. Reynolds Tobacco Co*., a case filed in December 2007, in the Circuit Court, Sarasota County, Florida, the court declared a mistrial due to the jury's inability to reach a unanimous verdict. The plaintiff alleged that as a result of using the defendant's products, the decedent, Marion Dion, suffered from one or more smoking-related diseases or conditions. The plaintiff seeks an unspecified amount of compensatory and punitive damages, costs and interest. Retrial is scheduled for April 25, 2016.

On March 25, 2015, in *Pollari v. R. J. Reynolds Tobacco Co.*, a case filed in May 2007, in the Circuit Court, Broward County, Florida, a jury returned a verdict in favor of the plaintiff, found the decedent, Paul Pollari, to be 15% at fault, RJR Tobacco to be 42.5% at fault and the remaining defendant to be 42.5% at fault, and awarded $10 million in compensatory damages and $1.5 million in punitive damages against each defendant. The plaintiff alleged that as a result of using the defendants' products, the decedent suffered from lung cancer. The plaintiff sought an unspecified amount of compensatory and punitive damages, costs and interest. Final judgment was entered against the defendants in the amount of $10 million in compensatory damages and $1.5 million in

punitive damages against each defendant. Post-trial motions were denied on January 4, 2016. A second amended final judgment was entered against RJR Tobacco on January 12, 2016, awarding $4.25 million in compensatory damages and $1.5 million in punitive damages. The defendants filed a joint notice of appeal to the Fourth DCA on January 27, 2016.

On April 2, 2015, in *Ryan v. R. J. Reynolds Tobacco Co.*, a case filed in August 2007, in the Circuit Court, Broward County, Florida, the court declared a mistrial due to the opinion being issued by the Florida Supreme Court in *Hess v. Philip Morris USA Inc*. The plaintiff alleges that as a result of using the defendants' products, he developed chronic obstructive pulmonary disease. The plaintiff sought an unspecified amount of compensatory and punitive damages, costs and interest. Retrial began on April 8, 2015. On April 17, 2015, the jury returned a verdict in favor of the plaintiff, found the plaintiff to be 35% at fault and RJR Tobacco to be 65% at fault and awarded $21.5 million in compensatory damages and $25 million in punitive damages. In May 2015, RJR Tobacco filed its post-trial motions, and final judgment was entered against RJR Tobacco in the amount of $21.5 million in compensatory damages and $25 million in punitive damages. At a hearing on December 4, 2015, the court denied RJR Tobacco's motion for a new trial, but ruled that the judgment would be amended to reduce the compensatory damages award to reflect the jury's allocation of fault to the smoker. The court has not yet entered the amended final judgment or filed written orders denying the defendant's post-trial motions.

On May 21, 2015, in *Ethel Gray v. R. J. Reynolds Tobacco Co.*, a case pending in Escambia County, Florida, a jury returned a verdict in favor of RJR Tobacco. The plaintiff alleged that as a result of using the defendant's products, the decedent, Willie Gray, suffered from peripheral vascular disease and chronic obstructive pulmonary disease. The plaintiff sought an unspecified amount of damages, costs and interest. Final judgment has not been entered.

On June 18, 2015, in *Hardin v. R. J. Reynolds Tobacco Co.*, a case filed in December 2007, in the Circuit Court, Miami-Dade County, Florida, a jury returned a verdict in favor of the plaintiff, found the decedent, Thomas Hardin, to be 87% at fault and RJR Tobacco to be 13% at fault, and awarded $776,000 in compensatory damages. Punitive damages were not awarded. The plaintiff alleged that as a result of using the defendant's products, the decedent suffered from one or more smoking-related diseases or conditions, and sought an unspecified amount of compensatory and punitive damages, costs and interest. Final judgment was entered against RJR Tobacco in the amount of $100,880 in June 2015. Post-trial motions are pending.

On July 13, 2015, in *McCoy v. R. J. Reynolds Tobacco Co.*, a case filed in December 2007, in the Circuit Court, Broward County, Florida, a jury returned a verdict in favor of the plaintiff, found the decedent, Glodine McCoy, 35% at fault, RJR Tobacco 25% at fault, Lorillard Tobacco 20% at fault and the remaining defendant 20% at fault, and awarded $1.5 million in compensatory damages. The jury also awarded $3 million in punitive damages against each defendant. The plaintiff alleged that as a result of using the defendants' products, the decedent suffered from lung cancer and other smoking-related diseases and/or conditions. The plaintiff sought an unspecified amount of compensatory and punitive damages, recoverable costs and interest. In August 2015, the court entered final judgment against RJR Tobacco, RJR Tobacco as successor-by-merger to Lorillard Tobacco, and the remaining defendant, jointly and severally, in the amount of $1.5 million in compensatory damages and $3 million in punitive damages against each of RJR Tobacco, RJR Tobacco as successor-by-merger to Lorillard Tobacco, and the remaining defendant. Post-trial motions were denied and an amended final judgment was entered in the amount of $370,000 in compensatory damages and $3 million in punitive damages against RJR Tobacco, $300,000 in compensatory damages and $3 million in punitive damages against RJR Tobacco as successor-by-merger to Lorillard Tobacco, and $300,000 in compensatory damages and $3 million in punitive damages against the remaining defendant on January 4, 2016. RJR Tobacco filed a notice of appeal to the Fourth DCA and posted a supersedeas bond in the amount of approximately $3.35 million, and the plaintiff filed a notice of cross appeal in January 2016. Briefing is underway.

On July 29, 2015, in *Collar v. R. J. Reynolds Tobacco Co.*, a case filed in January 2008, in the Circuit Court, Indian River County, Florida, a jury returned a verdict in favor of the defendants, including RJR Tobacco. The plaintiff alleged that as a result of using the defendants' products, she suffers from chronic obstructive pulmonary disease and heart disease. The plaintiff sought an unspecified amount of damages, costs and interest. Final judgment was entered in September 2015. Post-trial motions were denied on September 15, 2015. In October 2015, the plaintiff filed a notice of appeal and the defendants filed a joint notice of cross appeal to the Fourth DCA. Briefing is underway.

On August 7, 2015, in *Block v. R. J. Reynolds Tobacco Co.*, a case filed in October 2007, in the Circuit Court, Broward County, Florida, a jury returned a verdict in favor of the plaintiff, found the decedent, Lillian Kaplan, 50% at fault, RJR Tobacco 50% at fault, and awarded approximately $1.03 million in compensatory

damages and $800,000 in punitive damages. The plaintiff alleged that as a result of using the defendant's products, the decedent suffered from chronic obstructive pulmonary disease and emphysema. The plaintiff sought an unspecified amount of compensatory damages, costs and interest. Final judgment was entered against RJR Tobacco in the amount of approximately $926,000 in compensatory damages and $800,000 in punitive damages in September 2015. On December 9, 2015, the court granted RJR Tobacco's motion to alter or amend the judgment in part in light of the Fourth DCA's decision in *Schoeff v. R. J. Reynolds Tobacco Co.*, described above. The court decided that the intentional tort exception in Section 768.81, Florida Statutes, does not apply to the fraud and conspiracy claims brought by *Engle* Progeny plaintiffs. As a result, an amended final judgment was entered in the amount of approximately $463,000 in compensatory damages and $800,000 in punitive damages. All other post-trial motions were denied. In January 2016, RJR Tobacco filed a notice of appeal and posted a supersedeas bond in the amount of approximately $1.3 million, and the plaintiff filed a notice of cross appeal to the Fourth DCA. Briefing is underway.

On August 18, 2015, in *Santos v. R. J. Reynolds Tobacco Co.*, a case filed in January 2008, in the Circuit Court, Broward County, Florida, a jury returned a verdict in favor of RJR Tobacco. The plaintiff alleged that as a result of using the defendant's products, the decedent, Renato Santos, suffered from emphysema and chronic obstructive pulmonary disease. The plaintiff sought, among other forms of relief, an unspecified amount of compensatory and punitive damages. Final judgment was entered on September 21, 2015. The plaintiff did not seek further review.

On September 1, 2015, in *Lewis v. R. J. Reynolds Tobacco Co*., a case filed in December 2007, in the Circuit Court, Volusia County, Florida, a jury returned a verdict in favor of the plaintiff, found the decedent, Rosemary Lewis, 75% at fault, RJR Tobacco 25% at fault, and awarded $750,000 in compensatory damages. Punitive damages were not awarded. The plaintiff alleged that as a result of using the defendant's products, the decedent suffered from one or more smoking-related diseases or conditions. The plaintiff sought an unspecified amount of compensatory and punitive damages. Post-trial motions were denied on December 17, 2015. Final judgment has not been entered.

On September 8, 2015, in *Cooper v. R. J. Reynolds Tobacco Co.*, a case filed in December 2007, in the Circuit Court, Broward County, Florida, a jury returned a verdict in favor of the plaintiff, found the plaintiff 50% at fault, RJR Tobacco 40% at fault and the remaining defendant 10% at fault, and awarded $4.5 million in compensatory damages. Punitive damages were not awarded. The plaintiff alleged that as a result of using the defendants' products, she suffers from one or more smoking-related diseases or conditions, and sought an unspecified amount of compensatory and punitive damages, costs and interest. Post-trial motions were denied on December 2, 2015. Final judgment has not been entered.

On September 11, 2015, in *Duignan v. R. J. Reynolds Tobacco Co.*, a case filed in December 2007, in the Circuit Court, Pinellas County, Florida, a jury returned a verdict in favor of the plaintiff, found the decedent, Douglas Duignan, 33% at fault, RJR Tobacco 30% at fault, the remaining defendant 37% at fault, and awarded $6 million in compensatory damages and $2.5 million in punitive damages against RJR Tobacco and $3.5 million in punitive damages against the remaining defendant. The plaintiff alleged that as a result of using the defendants' products, the decedent suffered from lung cancer. The plaintiff sought an unspecified amount of compensatory damages, punitive damages, taxable costs and interest. Final judgment was entered against RJR Tobacco and the remaining defendant in the amount of $6 million in compensatory damages and $2.5 million in punitive damages against RJR Tobacco and $3.5 million in punitive damages against the remaining defendant. Post-trial motions were denied in October 2015. The defendants filed a joint notice of appeal to the Second DCA, and RJR Tobacco posted a supersedeas bond in the amount of approximately $2.3 million, in November 2015. Briefing is underway.

On September 11, 2015, in *O'Hara v. R. J. Reynolds Tobacco Co.*, a case filed in December 2007, in the Circuit Court, Escambia County, Florida, a jury returned a verdict in favor of the plaintiff, found the decedent, Garry O'Hara, 15% at fault and RJR Tobacco 85% at fault, and awarded $14.7 million in compensatory damages and $20 million in punitive damages. The plaintiff alleged that as a result of using the defendant's products, the decedent suffered from one or more smoking-related diseases or conditions. The plaintiff sought an unspecified amount of compensatory and punitive damages. Final judgment was entered in September 2015 against RJR Tobacco in the amount of $14.7 million in compensatory damages and $20 million in punitive damages. Post-trial motions were denied in November 2015. RJR Tobacco filed a notice of appeal to the First DCA on December 12, 2015.

On September 22, 2015, in *Suarez v. R. J. Reynolds Tobacco Co.*, a case filed in January 2008, in the Circuit Court, Miami-Dade County, Florida, the jury returned a verdict in favor of the defendants, including RJR

Tobacco. The plaintiff alleged that as a result of using the defendants' products, the decedent, Pio Suarez, suffered from one or more smoking-relating diseases and/or conditions. The plaintiff sought an unspecified amount of compensatory damages, costs and interest. Post-trial motions were denied, and final judgment was entered in November 2015. The plaintiff filed a notice of appeal, and the defendants filed a notice of cross appeal, to the Third DCA in December 2015. Briefing is underway.

On October 5, 2015, in *Gordon v. R. J. Reynolds Tobacco Co.*, a case filed in January 2008, in the Circuit Court, Charlotte County, Florida, a jury returned a verdict in favor of the plaintiff, found the decedent, Ann Gordon, 98% at fault and RJR Tobacco 2% at fault, and awarded $5,000 in compensatory damages. The plaintiff alleged that as a result of using the defendant's products, the decedent suffered from one or more smoking-related diseases or conditions. The plaintiff sought an unspecified amount of damages plus taxable costs and interest. Final judgment was entered against RJR Tobacco in the amount of $100. The plaintiff did not seek further review.

On October 6, 2015, in *Marchese v. R. J. Reynolds Tobacco Co.*, a case filed in April 2007, in the Circuit Court, Broward County, Florida, a jury returned a verdict in favor of the plaintiff, found the decedent, Salvatore Gertrude, 55% at fault, RJR Tobacco 22.5% at fault, and the remaining defendant 22.5% at fault, and awarded $1 million in compensatory damages. The jury also awarded $250,000 in punitive damages against each defendant. The plaintiff alleged that as a result of using the defendants' products, the decedent suffered from one or more smoking-related diseases or conditions. The plaintiff sought an unspecified amount of compensatory and punitive damages, costs and interest. Post-trial motions are pending. Final judgment has not been entered.

On October 26, 2015, in *Robertson v. R. J. Reynolds Tobacco Co.*, a case filed in December 2007, in the Circuit Court, Broward County, Florida, a jury returned a verdict in favor of RJR Tobacco. The plaintiff alleged that as a result of using the defendant's products, the decedent, David Robertson, suffered from lung cancer. The plaintiff sought an unspecified amount of compensatory damages and interest. Final judgment was entered on November 12, 2015. The plaintiff did not seek further review.

On November 18, 2015, in *Barbose v. R. J. Reynolds Tobacco Co.*, a case pending in Pasco County, Florida, a jury returned a verdict in favor of the plaintiff, found the decedent, John Barbose, 15% at fault, RJR Tobacco 42.5% at fault and the remaining defendant 42.5% at fault, and awarded $10 million in compensatory damages and $1 million in punitive damages. The damages are to be split equally. The plaintiff alleged that as a result of using the defendants' products, the decedent suffered from one or more smoking-related diseases and/or conditions. The plaintiff sought an unspecified amount of compensatory and punitive damages. Post-trial motions were denied on January 21, 2016. The deadline to file a notice of appeal is February 22, 2016.

On November 20, 2015, in *Fanali v. R. J. Reynolds Tobacco Co.*, a case filed in January 2008, in the Circuit Court, Palm Beach County, Florida, a jury returned a verdict in favor of RJR Tobacco. The plaintiff alleged that as a result of using the defendant's products, the decedent, Thomas Cavalier, suffered from lung cancer and other smoking-related diseases and/or conditions. The plaintiff sought an unspecified amount of compensatory and punitive damages. Final judgment was entered in favor of RJR Tobacco on December 17, 2015. In January 2016, the plaintiff filed a notice of appeal, and RJR Tobacco filed a notice of cross appeal, to the Fourth DCA. Briefing is underway.

On November 23, 2015, in *Shulman v. R. J. Reynolds Tobacco Co.*, a case filed in December 2007, in the Circuit Court, Palm Beach County, Florida, a jury returned a verdict in favor of the defendants, including RJR Tobacco. The plaintiff alleged that as a result of using the defendants' products, he suffers from bladder cancer, coronary artery disease and chronic obstructive pulmonary disease. The plaintiff sought an unspecified amount of compensatory and punitive damages. Final judgment was entered, the plaintiff filed a notice of appeal and an amended notice of appeal, and the defendants filed a notice of cross appeal to the Fourth DCA in December 2015. Briefing is underway.

On November 24, 2015, in *Green v. R. J. Reynolds Tobacco Co.*, a case filed in December 2007, in the Circuit Court, Miami-Dade County, Florida, a jury returned a verdict in favor of RJR Tobacco. The plaintiff alleged that as a result of using the defendant's products, she suffers from emphysema. The plaintiff sought an unspecified amount of compensatory and punitive damages. Post-trial motions are pending.

On December 9, 2015, in *Monroe v. R. J. Reynolds Tobacco Co.*, a case pending in Gadsden County, Florida, a jury returned a verdict in favor of the plaintiff, found the plaintiff 42% at fault and RJR Tobacco 58% at fault, and awarded $11 million in compensatory damages. Punitive damages were not awarded. The plaintiff alleged that as a result of using the defendant's products, she developed laryngeal cancer. The plaintiff sought an unspecified amount of damages. Final judgment was entered against RJR Tobacco in the amount of $6.38 million in compensatory damages on December 31, 2015. Post-trial motions are pending.

On December 21, 2015, in *Ledoux v. R. J. Reynolds Tobacco Co.*, a case filed in December 2007, in the Circuit Court, Miami-Dade County, Florida, a jury returned a verdict in favor of the plaintiff, found the decedent, Patricia Ledoux, 6% at fault, RJR Tobacco 47% at fault and the remaining defendant 47% at fault, and awarded $10 million in compensatory damages and $12.5 million in punitive damages against each defendant. The plaintiff alleged that as a result of using the defendants' products, the decedent suffered from lung cancer. The plaintiff sought an unspecified amount of compensatory and punitive damages, costs and interest. Final judgment was entered against the defendants, jointly and severally, in the amount of $10 million in compensatory damages. Punitive damages of $12.5 million was entered against each defendant. Post-trial motions are pending.

On January 25, 2016, in *Howles v. R. J. Reynolds Tobacco Co.*, a case filed in December 2007, in the Circuit Court, Broward County, Florida, the court declared a mistrial because the jury was unable to reach a unanimous verdict. The plaintiff alleged that as a result of using the defendants' products, she developed an addiction and suffers from one or more smoking-related diseases, including lung cancer. The plaintiff sought an unspecified amount of compensatory and punitive damages, costs and interest. A new trial date has not been scheduled.

On January 26, 2016, in *Rounds v. R. J. Reynolds Tobacco Co.*, a case filed in December 2007, in the Circuit Court, Volusia County, Florida, a jury returned a verdict in favor of RJR Tobacco. The plaintiff alleged that as a result of using the defendant's products, the decedent, Terrence Rounds, allegedly suffered from lung cancer. The plaintiff sought an unspecified amount of compensatory damages, costs and interest.

On January 26, 2016, in *Ewing v. R. J. Reynolds Tobacco Co.*, a case pending in the Circuit Court, Escambia County, Florida, a jury returned a verdict in favor of the plaintiff, found the decedent, James Ewing, 98% at fault, RJR Tobacco 2% at fault and the remaining defendant 0% at fault, and awarded $240,000 in compensatory damages. Punitive damages were not awarded. The plaintiff alleged that as a result of using the defendants' products, the decedent suffered from one or more smoking-related diseases. The plaintiff sought an unspecified amount of compensatory and punitive damages, costs and interest. Post-trial motions are due by February 12, 2016.

Broin II Cases

RJR Tobacco, Lorillard Tobacco, B&W and other cigarette manufacturer defendants settled *Broin v. Philip Morris, Inc.* in October 1997. This case had been brought in Florida state court on behalf of flight attendants alleged to have suffered from diseases or ailments caused by exposure to ETS in airplane cabins. The settlement agreement required the participating tobacco companies to pay a total of $300 million in three annual $100 million installments, allocated among the companies by market share, to fund research on the early detection and cure of diseases associated with tobacco smoke. It also required those companies to pay a total of $49 million for the plaintiffs' counsel's fees and expenses. RJR Tobacco's portion of these payments was approximately $86 million; Lorillard Tobacco's portion of these payments was approximately $57 million; and B&W's portion of these payments was approximately $31 million. The settlement agreement bars class members from bringing aggregate claims or obtaining punitive damages and also bars individual claims to the extent that they are based on fraud, misrepresentation, conspiracy to commit fraud or misrepresentation, RICO, suppression, concealment or any other alleged intentional or willful conduct. The defendants agreed that, in any individual case brought by a class member, the defendant will bear the burden of proof with respect to whether ETS can cause certain specifically enumerated diseases, referred to as "general causation." With respect to all other issues relating to liability, including whether an individual plaintiff's disease was caused by his or her exposure to ETS in airplane cabins, referred to as "specific causation," the individual plaintiff will have the burden of proof. On September 7, 1999, the Florida Supreme Court approved the settlement.

The *Broin II* cases arose out of the settlement of this case.

On October 5, 2000, the *Broin* court entered an order applicable to all *Broin II* cases that the terms of the *Broin* settlement agreement do not require the individual *Broin II* plaintiffs to prove the elements of strict liability, breach of warranty or negligence.

Under this order, there is a rebuttable presumption in the plaintiffs' favor on those elements, and the plaintiffs bear the burden of proving that their alleged adverse health effects actually were caused by exposure to ETS in airplane cabins, that is, specific causation.

As of December 31, 2015, there were 2,499 *Broin II* lawsuits pending in Florida. There have been no *Broin II* trials since 2007.

Class-Action Suits

Overview. As of December 31, 2015, 16 class-action cases, excluding the shareholder cases described below, were pending in the United States against Reynolds Defendants. These class actions seek recovery for personal injuries allegedly caused by cigarette smoking or, in some cases, for economic damages allegedly incurred by cigarette or e-cigarette purchasers.

In 1996, the Fifth Circuit Court of Appeals in *Castano v. American Tobacco Co.* overturned the certification of a nation-wide class of persons whose claims related to alleged addiction to tobacco products. Since this ruling by the Fifth Circuit, most class-action suits have sought certification of state-wide, rather than nation-wide, classes. Class-action suits based on claims similar to those asserted in *Castano,* claims that class members are at a greater risk of injury or injured by the use of tobacco or exposure to ETS, or claims that seek primarily economic damages are pending against RJR Tobacco, Lorillard Tobacco, or their affiliates or indemnitees in state or federal courts in Illinois, Louisiana, Missouri, West Virginia, California, Florida, New York and New Mexico. All pending class-action cases are discussed below.

The pending class actions against RJR Tobacco or its affiliates or indemnitees include four cases alleging that the use of the term "lights" constitutes unfair and deceptive trade practices under state law or violates the federal RICO statute. Such suits are pending in state or federal courts in Illinois and Missouri and are discussed below under "— 'Lights' Cases."

E-cigarette class-action cases are pending against RJR Vapor, RAI, and other RAI affiliates in California. In general, the plaintiffs allege that RJR Vapor, Lorillard Tobacco, and other RAI affiliates made false and misleading claims that e-cigarettes are less hazardous than other cigarette products or failed to disclose that e-cigarettes expose users to certain substances. The cases are typically filed pursuant to state consumer protection and related statutes and seek recovery of economic damages.

Several class actions relating to claims in advertising and promotional materials for SFNTC's NATURAL AMERICAN SPIRIT brand cigarettes are pending in federal courts. In general, these plaintiffs allege that use of the words "natural," "additive-free," or "organic" in NATURAL AMERICAN SPIRIT advertising and promotional materials suggests that those cigarettes are less harmful than other cigarettes and, for that reason, violated state consumer protection statutes or amounted to fraud or a negligent or intentional misrepresentation. The cases seek various combinations of recovery, including economic damages, treble damages, statutory damages, punitive damages, injunctive relief (including medical monitoring), and attorneys' fees, costs and expenses.

Finally, certain third-party payers have filed health-care cost recovery actions in the form of class actions. These cases are discussed below under "— Health-Care Cost Recovery Cases."

Few smoker class-action complaints have been certified or, if certified, have survived on appeal. Eighteen federal courts, including two courts of appeals, and most state courts that have considered the issue have rejected class certification in such cases. Apart from the *Castano* case discussed above, only two smoker class actions have been certified by a federal court — *In re Simon (II) Litigation,* and *Schwab [McLaughlin] v. Philip Morris USA, Inc.*, both of which were filed in the U.S. District Court for the Eastern District of New York and were ultimately decertified.

Camel Cash Cases. Sateriale v. R. J. Reynolds Tobacco Co., is a class action filed in November 2009 in the U.S. District Court for the Central District of California relating to the termination of a series of promotions by RJR Tobacco's CAMEL brand from 1991 to 2007 known as "Camel Cash." The plaintiffs originally brought the case on behalf of a putative class of all persons who tried unsuccessfully to redeem Camel Cash certificates from October 1, 1991 through March 31, 2007, or who held Camel Cash certificates as of March 31, 2007. The plaintiffs alleged that RJR Tobacco failed to have any rewards available during the final promotional period. The plaintiffs alleged claims based on the California Unfair Competition Law, the California Consumer Legal Remedies Law, breach of contract and promissory estoppel, and the plaintiffs sought injunctive relief, actual damages, costs and expenses. In January 2010, RJR Tobacco filed a motion to dismiss. In February 2010, the plaintiffs filed an amended complaint. In the amended complaint, the proposed class definition changed to a class consisting of all persons who reside in the U.S. and tried unsuccessfully to redeem Camel Cash certificates, also referred to as C-Notes, from October 1, 2006 to March 31, 2007. The plaintiffs also proposed a California subclass consisting of persons in California meeting the same criteria. In May 2010, RJR Tobacco's motion to dismiss the amended complaint for lack of subject matter jurisdiction and, alternatively, for failure to state a claim was granted with leave to amend. The plaintiffs filed a second amended complaint. In July 2010, RJR Tobacco's motion to dismiss the second amended complaint was granted with leave to amend. The plaintiffs

filed a third amended complaint, and RJR Tobacco filed a motion to dismiss in September 2010. In December 2010, the district court granted RJR Tobacco's motion to dismiss with prejudice and entered final judgment. In January 2011, the plaintiffs filed a notice of appeal. In July 2012, the U.S. Court of Appeals for the Ninth Circuit, referred to as the Ninth Circuit, affirmed the dismissal of the plaintiffs' claims under the California Unfair Competition Law and the California Consumer Legal Remedies Acts and reversed the dismissal of the plaintiffs' claims for promissory estoppel and breach of contract. In October 2012, the Ninth Circuit denied RJR Tobacco's motion for rehearing or rehearing *en banc*. RJR Tobacco filed its answer to the plaintiffs' third amended complaint in December 2012. Following the completion of discovery in June 2014, RJR Tobacco filed a motion for summary judgment, and the plaintiffs filed a motion for class certification. On December 19, 2014, the district court denied RJR Tobacco's motion for summary judgment, declined to certify a national class, found that the plaintiffs' promissory estoppel claim could not be tried on a class basis, and, on the plaintiffs' breach of contract claim, certified a class of "all persons in California who, as adult smokers, were assigned registration numbers by RJR Tobacco, collected C-Notes, and held C-Notes as of October 1, 2006." RJR Tobacco filed a motion to decertify the class and further discovery was stayed. Subsequently, the parties agreed to a settlement. Pursuant to the proposed settlement, RJR Tobacco would make available non-tobacco merchandise to class members for Camel Cash that they held on October 1, 2006, and pay plaintiffs' counsel $4.75 million in fees and costs. On January 19, 2016, the court granted its preliminary approval order for the settlement. A fairness hearing will be held by the court on May 2, 2016.

In *Feinman v. R. J. Reynolds Tobacco Co.*, a putative class action filed in September 2015, in the U.S. District Court for the Southern District of New York, the plaintiff brought a case against RJR Tobacco on behalf of a putative class of residents of New York, Iowa and South Dakota who were excluded from the California class in *Sateriale*; namely, all persons who resided in New York, Iowa or South Dakota as of October 1, 2006, and who, as adult smokers, purchased Camel-brand filtered cigarettes along with C-Notes, collected C-Notes and held C-Notes as of October 1, 2006. The plaintiff alleges breach of contract claims based on the termination of a series of promotions by RJR Tobacco's Camel brand from 1991 to 2007 known as "Camel Cash." On September 28, 2015, RJR Tobacco accepted service of process of the complaint. On January 16, 2016, the court conditionally approved the parties' settlement agreement and dismissal of the case subject to the court in *Sateriale* granting its final approval of that settlement agreement.

E-Cigarette Cases. In *Diek v. Lorillard Tobacco Co.,* a putative class action filed in April 2015, in the Superior Court of California, Orange County, the plaintiff brought a case against Lorillard Tobacco and two affiliated entities on behalf of a putative class of purchasers of one or more blu brand e-cigarettes, including e-juices, components thereof, cartridges or accessories sold by the defendants. The plaintiff alleges that certain advertising, marketing and packaging materials for blu brand e-cigarettes made deceptive claims and omitted material information. The plaintiff seeks injunctive relief under California Civil Code §1,750 *et seq*., injunctive and equitable relief under California Business & Professions Code §17,200 *et seq*., injunctive relief and damages under California Business and Professions Code §17,500 *et seq*., and damages for purported breaches of express warranty. On June 18, 2015, pursuant to the terms of the Asset Purchase Agreement, RAI tendered the defense of this action to, and sought indemnification for this action from, Imperial Sub. On June 26, 2015, the defendants removed the action to the U.S. District Court for the Central District of California. On October 2, 2015, the plaintiffs filed an amended complaint naming as defendants RAI, two RAI affiliates, Imperial Sub, and two Imperial Sub affiliates. Pursuant to the terms and conditions of the Asset Purchase Agreement, Imperial Sub has agreed to defend and indemnify RAI and its affiliates.

In *Whitney v. ITG Brands, LLC*, a putative class action filed in September 2015, in the U.S. District Court for the Northern District of California, the plaintiff brought a case against RAI, an RAI affiliate, Imperial Sub, and an Imperial Sub affiliate on behalf of a putative class of purchasers of blu brand e-cigarettes. The plaintiff alleges that certain advertising, marketing and packaging materials for blu brand e-cigarettes failed to advise purchasers and users that they potentially could be exposed to formaldehyde. The plaintiff asserts claims under California Business & Professions Code §17,200 *et seq.* and California Civil Code §1,750 *et seq*. and seeks declaratory relief, restitution, disgorgement, injunctive relief and damages. On September 18, 2015, pursuant to the terms of the Asset Purchase Agreement, RAI tendered the defense of this action to, and sought indemnification for this action from, Imperial Sub. Pursuant to the terms and conditions of the Asset Purchase Agreement, Imperial Sub has agreed to defend and indemnify RAI and its affiliate.

In *Harris v. R. J. Reynolds Vapor Co.*, a putative class action filed in September 2015, in the U.S. District Court for the Northern District of California, the plaintiff brought a case against RJR Vapor on behalf of a putative class of purchasers of VUSE e-cigarettes. The plaintiff alleges that certain advertising, marketing and packaging materials for VUSE e-cigarettes failed to advise purchasers and users that they potentially could be

exposed to formaldehyde and acetaldehyde. The plaintiff asserts claim under California Business & Professions Code § 17,200 *et seq.* and California Civil Code § 1,750 *et seq.* and seeks declaratory relief, restitution, disgorgement, injunctive relief and damages. RJR Vapor accepted service of process on September 23, 2015. An amended complaint was subsequently filed alleging a violation of Proposition 65. RJR Vapor filed a motion to dismiss on January 8, 2016. A decision is pending.

In *Center for Environmental Health v. NJoy, Inc.*, on November 19, 2015, the Center for Environmental Health filed a complaint in the Superior Court, Alameda County, California against RJR Vapor and several other e-cigarette manufacturers asserting a violation of Proposition 65 for not disclosing that electronic cigarettes, including VUSE, allegedly expose consumers to formaldehyde and acetaldehyde. RJR Vapor filed an answer on December 29, 2015.

"*Lights*" *Cases*. As noted above, "lights" class-action cases are pending against RJR Tobacco or B&W in Illinois (2) and Missouri (2). The classes in these cases generally seek to recover $50,000 to $75,000 per class member for compensatory and punitive damages, injunctive and other forms of relief, and attorneys' fees and costs from RJR Tobacco and/or B&W. In general, the plaintiffs allege that RJR Tobacco or B&W made false and misleading claims that "lights" cigarettes were lower in tar and nicotine and/or were less hazardous or less mutagenic than other cigarettes. The cases typically are filed pursuant to state consumer protection and related statutes.

Many of these "lights" cases were stayed pending review of the *Good v. Altria Group, Inc.* case by the U.S. Supreme Court. In that "lights" class-action case against Altria Group, Inc. and Philip Morris USA Inc., the U.S. Supreme Court decided that these claims are not preempted by the Federal Cigarette Labeling and Advertising Act or by the Federal Trade Commission's, referred to as FTC, historic regulation of the industry. Since this decision in December 2008, a number of the stayed cases have become active again.

The seminal "lights" class-action case involves RJR Tobacco's competitor, Philip Morris, Inc. Trial began in *Price v. Philip Morris, Inc.* in January 2003. In March 2003, the trial judge entered judgment against Philip Morris in the amount of $7.1 billion in compensatory damages and $3 billion in punitive damages. Based on Illinois law, the bond required to stay execution of the judgment was set initially at $12 billion. Philip Morris pursued various avenues of relief from the $12 billion bond requirement. On December 15, 2005, the Illinois Supreme Court reversed the lower court's decision and sent the case back to the trial court with instructions to dismiss the case. On December 5, 2006, the trial court granted the defendant's motion to dismiss and for entry of final judgment. The case was dismissed with prejudice the same day. In December 2008, the plaintiffs filed a petition for relief from judgment, stating that the U.S. Supreme Court's decision in *Good v. Altria Group, Inc.* rejected the basis for the reversal. The trial court granted the defendant's motion to dismiss the plaintiffs' petition for relief from judgment in February 2009. In March 2009, the plaintiffs filed a notice of appeal to the Illinois Appellate Court, Fifth Judicial District, requesting a reversal of the February 2009 order and remand to the circuit court. On February 24, 2011, the appellate court entered an order, concluding that the two-year time limit for filing a petition for relief from a final judgment began to run when the trial court dismissed the plaintiffs' lawsuit on December 18, 2006. The appellate court therefore found that the petition was timely, reversed the order of the trial court, and remanded the case for further proceedings. Philip Morris filed a petition for leave to appeal to the Illinois Supreme Court. On September 28, 2011, the Illinois Supreme Court denied Philip Morris's petition for leave to appeal and returned the case to the trial court for further proceedings. In December 2012, the trial court denied the plaintiffs' petition for relief from the judgment. The plaintiffs filed a notice of appeal to the Illinois Appellate Court, Fifth Judicial District. In April 2014, the appellate court reinstated the 2003 verdict. In May 2014, Philip Morris filed a petition for leave to appeal to the Illinois Supreme Court and a motion for supervisory order. Philip Morris has requested the Illinois Supreme Court to direct the Fifth Judicial District to vacate its April 2014 judgment and to order the Fifth Judicial District to affirm the trial court's denial of the plaintiff's petition for relief from the judgment, or in the alternative, grant its petition for leave to appeal. On September 24, 2014, the Illinois Supreme Court agreed to hear Philip Morris's appeal. In November 2015, the Illinois Supreme Court vacated the judgments of the lower courts and dismissed the case without prejudice to allow the plaintiffs to file a motion to recall the mandate. The plaintiffs filed a motion to recall the mandate or for other appropriate relief in the Illinois Supreme Court, which was denied on January 11, 2016.

In *Turner v. R. J. Reynolds Tobacco Co.,* a case filed in February 2000, in Circuit Court, Madison County, Illinois, a judge certified a class in November 2001. In November 2003, the Illinois Supreme Court granted RJR Tobacco's motion for a stay pending the court's final appeal decision in the *Price* case mentioned above. The stay subsequently expired, and the court accordingly scheduled a series of status conferences, all of which were continued by agreement of the parties. The next status conference is scheduled for February 24, 2016.

In *Howard v. Brown & Williamson Tobacco Corp.,* another case filed in February 2000 in Circuit Court, Madison County, Illinois, a judge certified a class in December 2001. In June 2003, the trial judge issued an order staying all proceedings pending resolution of the *Price* case mentioned above. The plaintiffs appealed this stay order to the Illinois Fifth District Court of Appeals, which affirmed the Circuit Court's stay order in August 2005. There is currently no activity in the case.

A "lights" class-action case is pending against each of RJR Tobacco and B&W in Missouri. In *Collora v. R. J. Reynolds Tobacco Co.,* a case filed in May 2000 in Circuit Court, St. Louis County, Missouri, a judge in St. Louis certified a class in December 2003. In April 2007, the court granted the plaintiffs' motion to reassign *Collora* and the following cases to a single general division: *Craft v. Philip Morris USA Inc.* and *Black v. Brown & Williamson Tobacco Corp.,* discussed below. In April 2008, the court stayed the case pending U.S. Supreme Court review in *Good v. Altria Group, Inc*. A nominal trial date of January 10, 2011 was scheduled, but it did not proceed at that time. A status conference is scheduled for February 22, 2016.

Finally, in *Black v. Brown & Williamson Tobacco Corp.,* a case filed in November 2000 in Circuit Court, City of St. Louis, Missouri, the trial court, in April 2008, stayed the case pending U.S. Supreme Court review in *Good v. Altria Group, Inc.* A nominal trial date of January 10, 2011, was scheduled, but it did not proceed at that time. A status conference is scheduled for February 22, 2016.

In the event RJR Tobacco and its affiliates or indemnitees lose one or more of the pending "lights" class-action suits, RJR Tobacco, depending upon the amount of any damages ordered, could face difficulties in its ability to pay the judgment or obtain any bond required to stay execution of the judgment which could have a material adverse effect on RJR Tobacco's, and consequently RAI's, results of operations, cash flows or financial position.

No Additive/Natural Claim Cases. Following the FDA's August 27, 2015, warning letter to SFNTC relating to the use of the words "natural" and "additive-free" in the labeling, advertising, and promotional materials for NATURAL AMERICAN SPIRIT brand cigarettes, plaintiffs purporting to bring claims on behalf of themselves and others have filed putative class actions against SFNTC and RAI. There are currently a total of seven such actions that are pending in the U.S. district courts for the Southern and Middle Districts of Florida, Southern District of New York, District of New Mexico, and Northern District of California. The claims asserted in these actions are based on alleged violations of state deceptive and unfair trade practice statutes, state common law, fraud, negligent misrepresentation, and unjust enrichment, and the cases seek various combinations of recovery, including economic damages, injunctive relief, interest, restitution, disgorgement, treble and punitive damages, and attorneys' fees and costs. On January 6, 2016, the plaintiffs in one of these actions filed a motion before the U.S. Judicial Panel On Multidistrict Litigation to consolidate these actions, referred to as the MDL Motion. SFNTC and RAI responded to the motion on January 27, 2016, and the hearing before the Judicial Panel On Multidistrict Litigation is anticipated on the Panel's March 31, 2016 or May 26, 2016 hearing dates.

In *Sproule v. Santa Fe Natural Tobacco Co.*, a putative class action filed in September 2015, in the U.S. District Court for the Southern District of Florida, the plaintiff brought a case against SFNTC and RAI on behalf of a nationwide putative class of purchasers of NATURAL AMERICAN SPIRIT brand cigarettes. The plaintiff alleges that use of the words "natural," "additive-free," "organic," and "unadulterated tobacco product," suggests that NATURAL AMERICAN SPIRIT brand cigarettes are healthier than or present reduced health risks as compared to other cigarettes. The plaintiff asserts claims based on alleged violations of the Florida Deceptive and Unfair Trade Practices Act, as well as claims for fraud, negligent misrepresentation, unjust enrichment, and, as to RAI, for aiding and abetting and vicarious liability. The plaintiff seeks injunctive relief, including medical monitoring and smoking cessation programs, compensatory damages, civil penalties and statutory damages, prejudgment and post-judgment interest, attorneys' fees and punitive damages. The defendants filed a motion to dismiss on December 15, 2015. On January 26, 2016, the *Sproule* court stayed all proceedings pending resolution of the MDL Motion.

In *Brattain v. Santa Fe Natural Tobacco Co.,* a putative class action filed in October 2015, in the U.S. District Court for the Northern District of California, the plaintiff brought the case against SFNTC and RAI on behalf of a putative class of California purchasers of NATURAL AMERICAN SPIRIT brand cigarettes. The plaintiff alleges that use of the words "natural," "100% additive free," and "organic" suggests that NATURAL AMERICAN SPIRIT brand cigarettes are healthier than or present reduced health risks as compared to other cigarettes. The plaintiff asserts claims based on alleged violations of the California Business & Professions Code § 17,500 *et seq*., California Business & Professions Code § 17,200 *et seq.* and California Civil Code § 1,750 *et seq*., and seeks injunctive relief, restitution, disgorgement, compensatory damages, attorneys' fees, costs and prejudgment and post-judgment interest. The defendants filed a motion to dismiss on December 14, 2015. On January 22, 2016, the *Brattain* court stayed all proceedings pending resolution of the MDL Motion.

In *Rothman v. Santa Fe Natural Tobacco Co.*, a putative class action filed in November 2015, in the U.S. District Court for the Southern District of New York, the plaintiff brought a case against SFNTC and RAI on behalf of a putative class of New York purchasers of NATURAL AMERICAN SPIRIT brand cigarettes. The plaintiff alleges that the use of the words "natural" and "additive-free" suggest that NATURAL AMERICAN SPIRIT brand cigarettes present a lower risk of tobacco-related disease and are less harmful than other commercially available cigarettes. The plaintiff asserts claims based on alleged violations of New York General Business Law §§ 349-50 and a claim for unjust enrichment. The plaintiff seeks injunctive relief, compensatory damages, statutory damages, restitution, and attorneys' fees and expenses. The defendants have not yet filed their initial response. On January 25, 2016, the parties jointly requested a stay of all proceedings pending resolution of the MDL Motion.

In *Dunn v. Santa Fe Natural Tobacco Co.*, a putative class action filed in December 2015, in the U.S. District Court for the District of New Mexico, the plaintiff brought a case against SFNTC on behalf of a nationwide putative class (and Minnesota subclass) of purchasers of NATURAL AMERICAN SPIRIT brand cigarettes. The plaintiff alleges that the use of the word "natural" suggests that NATURAL AMERICAN SPIRIT brand cigarettes are less harmful than other commercially available cigarettes. The plaintiff asserts claims based on alleged violations of the Minnesota Consumer Fraud Act, Minnesota Unlawful Trade Practices Act, Minnesota Deceptive Trade Practices Act, Minnesota False Advertising Law, and New Mexico Unfair Trade Practices Act, negligent misrepresentation, and unjust enrichment. The plaintiff seeks compensatory, treble, and punitive damages, restitution, disgorgement, injunctive relief, and attorneys' fees and costs. The defendants have not yet filed their initial response. On February 1, 2016, the parties filed a joint motion to stay all proceedings pending resolution of the MDL Motion.

In *Haksal v. Santa Fe Natural Tobacco Co*., a putative class action filed in December 2015, in the U.S. District Court for the District of New Mexico, the plaintiffs brought a case against SFNTC and RAI on behalf of a nationwide putative class (and California, Illinois, Minnesota, and New Mexico subclasses) of purchasers of NATURAL AMERICAN SPIRIT brand cigarettes. The plaintiffs allege that the use of the words "natural," "additive-free," and "organic" and the use of Native American imagery, suggests that NATURAL AMERICAN SPIRIT brand cigarettes are less harmful than other commercially available cigarettes. The plaintiffs further challenge use of the description "natural" based on alleged use of artificial fertilizers and tobacco produced from genetically modified organism (GMO) tobacco, and allege false and misleading environmental claims. The plaintiffs assert claims based on alleged violations of the New Mexico Unfair Practices Act, New Mexico False Advertising Act, California Unfair Competition Law, California False Advertising Law, Minnesota Uniform Deceptive Trade Practices Act, Minnesota Prevention of Consumer Fraud Act, Minnesota False Statement in Advertising Act, Illinois Consumer Fraud and Deceptive Business Practices Act, and Illinois Uniform Deceptive Trade Practices Act, fraud, intentional misrepresentation, deceit, negligent misrepresentation, quasi-contract, and unjust enrichment. The plaintiffs seek compensatory exemplary, treble, and punitive damages, restitution, disgorgement, attorneys' fees and costs, and injunctive relief, including recall of allegedly unlawfully labeled product. The defendants have not yet filed their initial response. On February 1, 2016, the parties filed a joint motion to stay all proceedings pending resolution of the MDL Motion.

In *Cuebas v. Santa Fe Natural Tobacco Co*., a putative class action filed in January 2016, in the U.S. District Court for the Southern District of New York, the plaintiff brought a case against SFNTC and RAI on behalf of a nationwide putative class (and New York subclass) of purchasers of NATURAL AMERICAN SPIRIT brand cigarettes. The plaintiff alleges that the use of the words "natural," "additive-free," "100% additive free," "organic," and "unadulterated tobacco product" suggest that NATURAL AMERICAN SPIRIT brand cigarettes are less harmful than other commercially available cigarettes. The plaintiff asserts claims based on alleged violations of New York General Business Law §§ 349-50, fraud, negligent misrepresentation, and unjust enrichment. The plaintiff seeks compensatory, treble and exemplary damages, civil penalties, injunctive relief including medical monitoring and smoking cessation programs, interest, attorneys' fees, costs, and punitive damages. The defendants have not yet filed their initial response.

In *Okstad v. Santa Fe Natural Tobacco Co*., a putative class action filed in January 2016, in the U.S. District Court for the Middle District of Florida, the plaintiffs brought a case against SFNTC and RAI on behalf of a nationwide putative class and sixteen putative state-based subclasses (Alabama, California, Colorado, Florida, Georgia, Iowa, Illinois, Maryland, Maine, North Carolina, New Jersey, Ohio, Oregon, Pennsylvania, Texas and Wisconsin subclasses) of purchasers of NATURAL AMERICAN SPIRIT brand cigarettes. The plaintiffs allege that the use of the words "natural," "additive free," "100% additive free," "organic," and "unadulterated tobacco product" suggests that NATURAL AMERICAN SPIRIT brand cigarettes are less harmful than other commercially available cigarettes. On behalf of the putative nationwide class, plaintiffs assert common law

claims of alleged fraud, negligent misrepresentation, and unjust enrichment. On behalf of the 16 state-based subclasses, plaintiffs assert claims based on alleged violations of the Alabama Deceptive Trade Practice Act, California Consumers Legal Remedies Act, California False Advertising Law, Colorado Consumer Protection Act, Georgia's Fair Business Practices Act, Georgia's Uniform Deceptive Trade Practices Act, Illinois Consumer Fraud and Deceptive Business Practices Act, Iowa Private Right of Action for Consumer Frauds Act, Maine Unfair Trade Practices Act, Maryland Consumer Protection Act, New Jersey Consumer Fraud Act, North Carolina Unfair and Deceptive Trade Practices Act, Ohio Consumer Sales Practices Act, Oregon Unlawful Trade Practices Act, Pennsylvania Unfair Trade Practices and Consumer Protection Law, Texas Deceptive Trade Practices Act, and Wisconsin Deceptive Trade Practices Act. The plaintiffs seek compensatory, treble, and exemplary damages, injunctive relief, including medical monitoring and smoking cessation programs, civil penalties, interest, attorneys' fees, costs, and punitive damages. The defendants have not yet filed their initial response.

Other Class Actions. In *Young v. American Tobacco Co., Inc.*, a case filed in November 1997 in Circuit Court, Orleans Parish, Louisiana, the plaintiffs brought an ETS class action against U.S. cigarette manufacturers, including RJR Tobacco and B&W, and parent companies of U.S. cigarette manufacturers, including RJR, on behalf of all residents of Louisiana who, though not themselves cigarette smokers, have been exposed to secondhand 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. In March 2013, the court entered an order staying the case, including all discovery, pending the implementation of the smoking cessation program ordered by the court in *Scott v. The American Tobacco Co.*

In *Parsons v. A C & S, Inc.*, a case filed in February 1998 in Circuit Court, Ohio County, West Virginia, the plaintiff sued asbestos manufacturers, U.S. cigarette manufacturers, including RJR Tobacco, B&W, Lorillard Tobacco, and parent companies of U.S. cigarette manufacturers, including RJR and Lorillard, seeking to recover $1 million in compensatory and punitive damages individually and an unspecified amount for the class in both compensatory and punitive damages. The case was brought on behalf of persons who allegedly have personal injury claims arising from their exposure to respirable asbestos fibers and cigarette smoke. The plaintiffs allege that Mrs. Parsons' use of tobacco products and exposure to asbestos products caused her to develop lung cancer and to become addicted to tobacco. In December 2000, three defendants, Nitral Liquidators, Inc., Desseaux Corporation of North America and Armstrong World Industries, filed bankruptcy petitions in the U.S. Bankruptcy Court for the District of Delaware, *In re Armstrong World Industries, Inc.* Pursuant to section 362(a) of the Bankruptcy Code, *Parsons* is automatically stayed with respect to all defendants who filed for bankruptcy. The case remains pending against the other defendants, including RJR Tobacco and Lorillard Tobacco, but it has long been dormant.

Finally, in *Jones v. American Tobacco Co., Inc.*, a case filed in December 1998 in Circuit Court, Jackson County, Missouri, the defendants removed the case to the U.S. District Court for the Western District of Missouri in February 1999. The action was brought against the major U.S. cigarette manufacturers, including RJR Tobacco, B&W, Lorillard Tobacco, and parent companies of U.S. cigarette manufacturers, including RJR and Lorillard, 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 in February 1999. There is currently no activity in this case.

Filter Cases

Claims have been brought against Lorillard Tobacco and Lorillard by individuals who seek damages resulting from their alleged exposure to asbestos fibers that were incorporated into filter material used in one brand of cigarettes manufactured by a predecessor to Lorillard Tobacco for a limited period of time ending more than 50 years ago. As of December 31, 2015, Lorillard Tobacco and/or Lorillard was a defendant in 64 Filter Cases. Since January 1, 2012, Lorillard Tobacco has paid, or has reached agreement to pay, a total of approximately $51.8 million in settlements to resolve 187 claims asserted in Filter Cases.

Pursuant to the terms of a 1952 agreement between P. Lorillard Company and H&V Specialties Co., Inc. (the manufacturer of the filter material), Lorillard Tobacco is required to indemnify Hollingsworth & Vose for legal fees, expenses, judgments and resolutions in cases and claims alleging injury from finished products sold by P. Lorillard Company that contained the filter material.

On September 13, 2013, the jury in *DeLisle v. A. W. Chesterton Company*, a case tried in the Circuit Court for the 17th Judicial Circuit, Broward County, Florida, found in favor of the plaintiffs as to their claims for

negligence and strict liability, and awarded $8 million. Lorillard Tobacco is responsible for 44%, or $3.52 million. Judgment was entered on November 6, 2013. Lorillard Tobacco filed its notice of appeal on November 18, 2013. Briefing is complete. Oral argument is scheduled for February 16, 2016.

Health-Care Cost Recovery Cases

Health-care cost recovery cases have been brought by a variety of plaintiffs. Other than certain governmental actions, these cases largely have been unsuccessful on remoteness grounds, which means that one who pays an injured person's medical expenses is legally too remote to maintain an action against the person allegedly responsible for the injury.

As of December 31, 2015, two health-care cost recovery cases were pending in the United States against RJR Tobacco, B&W, Lorillard Tobacco, or all three, as discussed below after the discussion of the State Settlement Agreements. A limited number of claimants have filed suit against RJR Tobacco, one of its affiliates, and other tobacco industry defendants to recover funds for health care, medical and other assistance paid by foreign provincial governments in treating their citizens. For additional information on these cases, see "— International Cases" below.

State Settlement Agreements. In June 1994, the Mississippi Attorney General brought an action, *Moore v. American Tobacco Co.*, against various industry members, including RJR Tobacco, B&W and Lorillard Tobacco. This case was brought on behalf of the state to recover state funds paid for health care and other assistance to state citizens suffering from diseases and conditions allegedly related to tobacco use. Most other states, through their attorneys general or other state agencies, sued RJR Tobacco, B&W, Lorillard Tobacco and other U.S. cigarette manufacturers based on similar theories. The cigarette manufacturer defendants, including RJR Tobacco, B&W and Lorillard Tobacco, settled the first four of these cases scheduled for trial — Mississippi, Florida, Texas and Minnesota — by separate agreements with each such state.

On November 23, 1998, the major U.S. cigarette manufacturers, including RJR Tobacco, B&W and Lorillard Tobacco, entered into the Master Settlement Agreement with attorneys general representing the remaining 46 states, the District of Columbia, Puerto Rico, Guam, the Virgin Islands, American Samoa and the Northern Marianas. Effective on November 12, 1999, the MSA settled all the health-care cost recovery actions brought by, or on behalf of, the settling jurisdictions and released various additional present and future claims.

In the settling jurisdictions, the MSA released RJR Tobacco, B&W, Lorillard Tobacco, and their affiliates and indemnitees, including RAI and Lorillard, from:

- all claims of the settling states and their respective political subdivisions and other recipients of state health-care funds, relating to past conduct arising out of the use, sale, distribution, manufacture, development, advertising, marketing or health effects of, the exposure to, or research, statements or warnings about, tobacco products; and
- all monetary claims of the settling states and their respective political subdivisions and other recipients of state health- care funds, relating to future conduct arising out of the use of or exposure to, tobacco products that have been manufactured in the ordinary course of business.

Set forth below is the unadjusted tobacco industry settlement payment schedule (in millions) for 2013 and beyond:

	2013	2014	2015 and thereafter
First Four States' Settlements: (1)			
Mississippi Annual Payment	$ 136	$ 136	$ 136
Florida Annual Payment	440	440	440
Texas Annual Payment	580	580	580
Minnesota Annual Payment	204	204	204
Remaining Jurisdictions' Settlement:			
Annual Payments (1)	8,004	8,004	8,004
Total	$9,364	$9,364	$9,364

(1) Subject to adjustments for changes in sales volume, inflation and other factors. All payments are to be allocated among the companies on the basis of relative market share. For further information, see "— State Settlement Agreements — Enforcement and Validity; Adjustments" below.

RAI's operating subsidiaries expenses and payments under the State Settlement Agreements for 2013, 2014 and 2015, and the projected expenses and payments for 2016 and beyond (in millions) are set forth below (2).

	2013	2014	2015	2016	2017	2018 and thereafter
Settlement expenses	$1,819	$1,917	$2,403			—
Settlement cash payments	$2,582	$1,985	$2,166			—
Projected settlement expenses				$>2,800	$>3,100	$>3,200
Projected settlement cash payments				$>3,100	$>2,800	$>3,100

(2) Amounts beginning in 2013 reflect the impact of the Term Sheet described below under "— State Settlement Agreements — Enforcement and Validity; Adjustments — Partial Settlement of Certain NPM Adjustment Claims."

The State Settlement Agreements also contain provisions restricting the marketing of tobacco products. Among these provisions are restrictions or prohibitions on the use of cartoon characters, brand-name sponsorships, apparel and other merchandise, outdoor and transit advertising, payments for product placement, free sampling and lobbying. Furthermore, the State Settlement Agreements required the dissolution of three industry-sponsored research and trade organizations.

The State Settlement Agreements have materially adversely affected RJR Tobacco's shipment volumes. RAI believes that these settlement obligations may materially adversely affect the results of operations, cash flows or financial position of RAI and RJR Tobacco in future periods. The degree of the adverse impact will depend, among other things, on the rate of decline in U.S. cigarette sales in the premium and value categories, RJR Tobacco's share of the domestic premium and value cigarette categories, and the effect of any resulting cost advantage of manufacturers not subject to the State Settlement Agreements.

U.S. Department of Justice Case. On September 22, 1999, in *United States v. Philip Morris USA Inc*., the U.S. Department of Justice brought an action against RJR Tobacco, B&W, Lorillard Tobacco and other tobacco companies in the U.S. District Court for the District of Columbia. The government initially sought to recover federal funds expended by the federal government in providing health care to smokers who developed diseases and injuries alleged to be smoking-related, based on several federal statutes. In addition, the government sought, pursuant to the civil provisions of RICO, disgorgement of profits the government contends were earned as a consequence of a RICO racketeering "enterprise." In September 2000, the district court dismissed the government's claims asserted under the Medical Care Recovery Act as well as those under the Medicare Secondary Payer provisions of the Social Security Act, but did not dismiss the RICO claims. In February 2005, the D.C. Circuit ruled that disgorgement is not an available remedy in this case. The government's petition for writ of certiorari with the U.S. Supreme Court was denied in October 2005. The non-jury, bench trial began in September 2004, and closing arguments concluded in June 2005.

On August 17, 2006, the district court found certain defendants, including RJR Tobacco, B&W and Lorillard Tobacco had violated RICO, but did not impose any direct financial penalties. The district court instead enjoined RJR Tobacco, Lorillard Tobacco and the defendants from committing future racketeering acts, participating in certain trade organizations, making misrepresentations concerning smoking and health and youth marketing, and using certain brand descriptors such as "low tar," "light," "ultra light," "mild" and "natural." The district court also ordered RJR Tobacco, Lorillard Tobacco and the other defendants to issue "corrective communications" on five subjects, including smoking and health and addiction, and to comply with further undertakings, including maintaining web sites of historical corporate documents and disseminating certain marketing information on a confidential basis to the government. In addition, the district court placed restrictions on the defendants' ability to dispose of certain assets for use in the United States, unless the transferee agrees to abide by the terms of the district court's order, and ordered certain defendants to reimburse the U.S. Department of Justice its taxable costs incurred in connection with the case.

Certain defendants, including RJR Tobacco and Lorillard Tobacco, filed notices of appeal to the D.C. Circuit in September 2006. The government filed its notice of appeal in October 2006. In addition, the defendants, including RJR Tobacco and Lorillard Tobacco, filed joint motions asking the district court to clarify and to stay its order pending the defendants' appeal. On September 28, 2006, the district court denied the defendants' motion to stay. On September 29, 2006, the defendants, including RJR Tobacco and Lorillard Tobacco, filed a motion asking the D.C. Circuit to stay the district court's order pending the defendants' appeal. The D.C. Circuit granted the motion in October 2006.

In November 2006, the D.C. Circuit stayed the appeals pending the district court's ruling on the defendants' motion for clarification. The defendants' motion was granted in part and denied in part. The defendants' motion

as to the meaning and applicability of the general injunctive relief of the August 2006 order was denied. The request for clarification as to the scope of the provisions in the order prohibiting the use of descriptors and requiring corrective statements at retail point of sale was granted. The district court also ruled that the provisions prohibiting the use of express or implied health messages or descriptors do apply to the actions of the defendants taken outside of the United States.

In May 2009, the D.C. Circuit largely affirmed the finding of liability against the tobacco defendants and remanded to the trial court for dismissal of the trade organizations. The D.C. Circuit also largely affirmed the remedial order, including the denial of additional remedies, but vacated the order and remanded for further proceedings as to the following four discrete issues:

- the issue of the extent of B&W's control over tobacco operations was remanded for further fact finding and clarification;
- the remedial order was vacated to the extent that it binds all defendants' subsidiaries and was remanded to the district court for determination as to whether inclusion of the subsidiaries and which of the subsidiaries satisfy Rule 65(d) of the Federal Rules of Civil Procedure;
- the D.C. Circuit held that the provision found in paragraph four of the injunction, concerning the use of any express or implied health message or health descriptor for any cigarette brand, should not be read to govern overseas sales. The issue was remanded to the district court with instructions to reformulate it so as to exempt foreign activities that have no substantial, direct and foreseeable domestic effects; and
- the remedial order was vacated regarding "point of sale" displays and remanded for the district court to evaluate and make due provisions for the rights of innocent persons, either by abandoning this part of the remedial order or re-crafting a new version reflecting the rights of third parties.

RJR Tobacco, Lorillard Tobacco and the other defendants, as well as the Department of Justice, filed petitions for writ of certiorari to the U.S. Supreme Court in February 2010. In June 2010, the U.S. Supreme Court denied the parties' petitions for writ of certiorari.

Post-remand proceedings are underway to determine the extent to which the original order will be implemented. On December 22, 2010, the district court dismissed B&W from the litigation. On March 3, 2011, the defendants filed a motion for vacatur, in which they moved to vacate the district court's injunctions and factual findings and dismiss the case in its entirety. The court denied the motion on June 1, 2011. The defendants filed a notice of appeal. In addition, the parties to the lawsuit entered into an agreement concerning certain technical obligations regarding their public websites. Pursuant to this agreement, RJR Tobacco agreed to deposit $3.125 million, and Lorillard Tobacco agreed to deposit $650,000, over three years into the registry of the district court. Those deposits are now complete. In July 2012, the D.C. Circuit affirmed the district court's denial of the defendants' motion to vacate the injunctions. In November 2012, the trial court entered an order wherein the court determined the language to be included in the text of the corrective statements and directed the parties to engage in discussions with the Special Master to implement them. After extensive mediation led the parties to an implementation agreement, the district court entered an implementation order on June 2, 2014. The defendants filed a consolidated appeal challenging both the content of the court-ordered statements and the requirement that those statements be published in redundant media. On May 22, 2015, the D.C. Circuit reversed the corrective statements order in part, affirmed in part, and remanded to the district court for further proceedings. On June 30, 2015, the district court held a status conference to discuss briefing and scheduling of future submissions in light of the D.C. Circuit's decision on the corrective statement issue. On July 7, 2015, the U.S. Department of Justice filed a motion for rehearing with the D.C. Circuit, which was denied on August 5, 2015. On August 20, 2015, the district court directed the parties to undertake mediation in order to attempt to reach agreement on the wording of the corrective-statements preamble. The parties were unable to reach agreement. On October 1, 2015, the district court held a status conference at which it ordered the parties to propose new corrective-statements preambles and brief their proposals in October and November 2015. Proceedings on remand remain ongoing. In light of the corrective-statements implementation order, $20 million has been accrued for the estimated costs of the corrective communications and is included in the consolidated balance sheet as of December 31, 2015.

Native American Tribe Case. As of December 31, 2015, one Native American tribe case was pending before a tribal court against RJR Tobacco, B&W and Lorillard Tobacco, *Crow Creek Sioux Tribe v. American Tobacco Co.*, a case filed in September 1997 in Tribal Court, Crow Creek Sioux, South Dakota. The plaintiffs seek to recover actual and punitive damages, restitution, funding of a clinical cessation program, funding of a corrective public education program, and disgorgement of unjust profits from sales to minors. The plaintiffs claim that the

defendants are liable under the following theories: unlawful marketing and targeting of minors, contributing to the delinquency of minors, unfair and deceptive acts or practices, unreasonable restraint of trade and unfair method of competition, negligence, negligence per se, conspiracy and restitution of unjust enrichment. The case is dormant.

International Cases. Each of the ten Canadian provinces has filed a health-care cost recovery action against Canadian and non-Canadian tobacco-related entities, including RJR Tobacco and one of its affiliates. In these actions, the Canadian provinces are seeking to recover for health care, medical and other assistance paid and to be paid in treating their citizens for tobacco-related disease. Pursuant to the terms of the 1999 sale of RJR Tobacco's international tobacco business, RJR Tobacco has tendered the defense of these actions to JTI. Subject to a reservation of rights, JTI has assumed the defense of RJR Tobacco and its affiliate in these actions.

- *British Columbia* — In 1997, British Columbia enacted a statute, subsequently amended, which created a civil cause of action for the government to recover the costs of health-care benefits incurred for insured populations of British Columbia residents resulting from tobacco-related disease. An action brought on behalf of the Province of British Columbia pursuant to the statute against Canadian and non-Canadian tobacco-related entities, including RJR Tobacco and certain of its affiliates, was dismissed in February 2000 when the British Columbia Supreme Court ruled that the legislation was unconstitutional and set aside service ex juris against the foreign defendants for that reason. British Columbia then enacted a revised statute, pursuant to which an action was filed in January 2001 against many of the same defendants, including RJR Tobacco and one of its affiliates, in Supreme Court of British Columbia, Vancouver Registry. In that action, the British Columbia government seeks to recover the present value of its total expenditures for health-care benefits provided for insured persons resulting from tobacco-related disease or the risk of tobacco-related disease caused by alleged breaches of duty by the manufacturers, the present value of its estimated total expenditures for health-care benefits that reasonably could be expected to be provided for those insured persons resulting from tobacco-related disease or the risk of tobacco-related disease in the future, court ordered interest, and costs, or in the alternative, special or increased costs. The government alleges that the defendants are liable under the British Columbia statute by reason of their "tobacco related wrongs," which are alleged to include: selling defective products, failure to warn, sale of cigarettes to children and adolescents, strict liability, deceit and misrepresentation, violation of trade practice and competition acts, concerted action, and joint liability. RJR Tobacco and its affiliate filed statements of defense in January 2007. Pretrial discovery is ongoing.
- *New Brunswick* — In March 2008, a case was filed on behalf of Her Majesty the Queen in Right of the Province of New Brunswick, Canada, against Canadian and non-Canadian tobacco-related entities, including RJR Tobacco and one of its affiliates, in the Court of Queen's Bench of New Brunswick, Judicial District of Fredericton. The claim is brought pursuant to New Brunswick legislation enacted in 2008, which legislation is substantially similar to the revised British Columbia statute described above. In this action, the New Brunswick government seeks to recover essentially the same types of damages that are being sought in the British Columbia action described above based on analogous theories of liability. RJR Tobacco and its affiliate filed statements of defense in March 2010. Pretrial discovery is ongoing.
- *Ontario* — In September 2009, a case was filed on behalf of the Province of Ontario, Canada, against Canadian and non-Canadian tobacco-related entities, including RJR Tobacco and one of its affiliates, in the Ontario Superior Court of Justice, Toronto. The claim is brought pursuant to Ontario legislation enacted in 2009, which legislation is substantially similar to the revised British Columbia statute described above. In this action, the Ontario government seeks to recover essentially the same types of damages that are being sought in the British Columbia and New Brunswick actions described above based on analogous theories of liability, although the government also asserted claims based on the illegal importation of cigarettes, which claims were deleted in an amended statement of claim filed in August 2010. Preliminary motions are pending.
- *Newfoundland and Labrador* — In February 2011, a case was filed on behalf of the Province of Newfoundland and Labrador, Canada against Canadian and non-Canadian tobacco-related entities, including RJR Tobacco and one of its affiliates, in the Supreme Court of Newfoundland and Labrador, St. John's. The claim is brought pursuant to legislation passed in Newfoundland in 2001 and proclaimed in February 2011, which legislation is substantially similar to the revised British Columbia statute described above. In this action, the Newfoundland government seeks to recover essentially the

same types of damages that are being sought in the British Columbia and other provincial actions described above based on analogous theories of liability. Preliminary motions are pending.

- *Manitoba* — In May 2012, a case was filed on behalf of the Province of Manitoba, Canada, against Canadian and non-Canadian tobacco-related entities, including RJR Tobacco and one of its affiliates, in the Court of Queen's Bench, Winnipeg Judicial Centre. The claim is brought pursuant to legislation assented to in 2006 and proclaimed in 2012, which legislation is substantially similar to the revised British Columbia statute described above. In this action, the Manitoba government seeks to recover essentially the same types of damages that are being sought in the British Columbia and other provincial actions described above based on analogous theories of liability. A jurisdictional challenge brought by RJR Tobacco and its affiliate was dismissed. RJR Tobacco and its affiliate filed statements of defense in September 2014.
- *Quebec* — In June 2012, a case was filed on behalf of the Province of Quebec, Canada, against Canadian and non-Canadian tobacco-related entities, including RJR Tobacco and one of its affiliates, in the Superior Court of Quebec, District of Montreal. The claim is brought pursuant to legislation enacted in Quebec in 2009, which legislation is substantially similar to the revised British Columbia statute described above. In this action, the Quebec government seeks to recover essentially the same types of damages that are being sought in the British Columbia and other provincial actions described above based on analogous theories of liability. RJR Tobacco and its affiliate have brought a motion challenging the jurisdiction of the Quebec court, which was dismissed. RJR Tobacco and its affiliate filed defenses in December 2014. Pretrial discovery is ongoing. Separately, in August 2009, certain Canadian manufacturers filed a constitutional challenge to the Quebec statute, which was dismissed. An appeal from that decision was dismissed on September 28, 2015. Leave to appeal has been sought.
- *Saskatchewan* — In June 2012, a case was filed on behalf of the Province of Saskatchewan, Canada, against Canadian and non-Canadian tobacco-related entities, including RJR Tobacco and one of its affiliates, in the Court of Queen's Bench, Judicial Centre of Saskatoon. The claim is brought pursuant to legislation assented to in 2007 and proclaimed in 2012, which legislation is substantially similar to the revised British Columbia statute described above. In this action, the Saskatchewan government seeks to recover essentially the same types of damages that are being sought in the British Columbia and other provincial actions described above based on analogous theories of liability. RJR Tobacco and its affiliate filed statements of defense in February 2015.
- *Alberta* — In June 2012, a case was filed on behalf of the Province of Alberta, Canada, against Canadian and non-Canadian tobacco-related entities, including RJR Tobacco and one of its affiliates, in the Court of Queen's Bench of Alberta Judicial Centre of Calgary. The claim is brought pursuant to legislation assented to in 2009 and proclaimed in 2012, which legislation is substantially similar to the revised British Columbia statute described above. In this action, the Alberta government seeks to recover essentially the same types of damages that are being sought in the British Columbia and other provincial actions described above based on analogous theories of liability. Preliminary motions are pending.
- *Prince Edward Island* — In September 2012, a case was filed on behalf of the Province of Prince Edward Island, Canada, against Canadian and non-Canadian tobacco-related entities, including RJR Tobacco and one of its affiliates, in the Supreme Court of Prince Edward Island, Charlottetown. The claim is brought pursuant to legislation assented to in 2009 and proclaimed in 2012, which legislation is substantially similar to the revised British Columbia statute described above. In this action, the Prince Edward Island government seeks to recover essentially the same types of damages that are being sought in the British Columbia and other provincial actions described above based on analogous theories of liability. RJR Tobacco and its affiliate filed statements of defense in February 2015.
- *Nova Scotia* — In January 2015, a case was filed on behalf of the Province of Nova Scotia, Canada, against Canadian and non-Canadian tobacco-related entities, including RJR Tobacco and one of its affiliates, in the Supreme Court of Nova Scotia, Halifax. The claim is brought pursuant to legislation assented to in 2005 and proclaimed in 2014, which legislation is substantially similar to the revised British Columbia statute described above. In this action, the Nova Scotia government seeks to recover essentially the same types of damages that are being sought in the British Columbia and other provincial actions described above based on analogous theories of liability. RJR Tobacco and its affiliate filed statements of defense in July 2015.

The following seven putative Canadian class actions were filed against various Canadian and non-Canadian tobacco-related entities, including RJR Tobacco and one of its affiliates, in courts in the Provinces of Alberta, British Columbia, Manitoba, Nova Scotia, Ontario and Saskatchewan, although the plaintiffs' counsel have been actively pursuing only *Bourassa*, the action pending in British Columbia, at this time:

- In *Kunka v. Canadian Tobacco Manufacturers' Council*, a case filed in June 2009 in the Court of Queen's Bench, Winnepeg Judicial Centre against Canadian and non-Canadian tobacco-related entities, including RJR Tobacco and one of its affiliates, the plaintiff, an individual smoker, alleging her own addiction and chronic obstructive pulmonary disease, severe asthma and lung disease resulting from the use of tobacco products, is seeking compensatory and unspecified punitive damages on behalf of a proposed class comprised of all individuals, including their estates, and their dependents and family members, who purchased or smoked cigarettes manufactured by the defendants, as well as restitution of profits and reimbursement of government expenditure for health-care benefits allegedly caused by the use of tobacco products.
- In *Dorion v. Canadian Tobacco Manufacturers' Council*, a case filed in June 2009, in the Court of Queen's Bench of Alberta, Judicial Centre of Calgary against Canadian and non-Canadian tobacco-related entities, including RJR Tobacco and one of its affiliates, the plaintiff, an individual smoker, alleging her own addiction and chronic bronchitis resulting from the use of tobacco products, is seeking compensatory and unspecified punitive damages on behalf of a proposed class comprised of all individuals, including their estates, dependents and family members, who purchased or smoked cigarettes designed, manufactured, marketed or distributed by the defendants, as well as restitution of profits and reimbursement of government expenditure for health-care benefits allegedly caused by the use of tobacco products.
- In *Semple v. Canadian Tobacco Manufacturers' Council*, a case filed in June 2009 in the Supreme Court of Nova Scotia, Halifax against Canadian and non-Canadian tobacco-related entities, including RJR Tobacco and one of its affiliates, the plaintiff, an individual smoker, alleging his own addiction and chronic obstructive pulmonary disease resulting from the use of tobacco products, is seeking compensatory and unspecified punitive damages on behalf of a proposed class comprised of all individuals, including their estates, dependents and family members, who purchased or smoked cigarettes designed, manufactured, marketed or distributed by the defendants for the period from January 1, 1954, to the expiry of the opt-out period as set by the court, as well as restitution of profits and reimbursement of government expenditure for health-care costs allegedly caused by the use of tobacco products.
- In *Adams v. Canadian Tobacco Manufacturers' Council*, a case filed in July 2009 in the Court of Queen's Bench, Judicial Centre of Regina, against Canadian and non-Canadian tobacco-related entities, including RJR Tobacco and one of its affiliates, the plaintiff, an individual smoker, alleging her own addiction and chronic obstructive pulmonary disease resulting from the use of tobacco products, is seeking compensatory and unspecified punitive damages on behalf of a proposed class comprised of all individuals who were alive on July 10, 2009, and who have suffered, or who currently suffer, from chronic obstructive pulmonary disease, emphysema, heart disease or cancer, after having smoked a minimum of 25,000 cigarettes designed, manufactured, imported, marketed or distributed by the defendants, as well as disgorgement of revenues earned by the defendants. RJR Tobacco and its affiliate have brought a motion challenging the jurisdiction of the Saskatchewan court.
- In *Bourassa v. Imperial Tobacco Canada Limited*, a case filed in June 2010 in the Supreme Court of British Columbia, Victoria Registry against Canadian and non-Canadian tobacco-related entities, including RJR Tobacco and one of its affiliates, the plaintiff, the heir to a deceased smoker, alleging that the deceased was addicted to and suffered emphysema resulting from the use of tobacco products, is seeking compensatory and unspecified punitive damages on behalf of a proposed class comprised of all individuals, including their estates, who were alive on June 12, 2007, and who have suffered, or who currently suffer from chronic respiratory diseases, after having smoked a minimum of 25,000 cigarettes designed, manufactured, imported, marketed, or distributed by the defendants, as well as disgorgement of revenues earned by the defendants from January 1, 1954, to the date the claim was filed. RJR Tobacco and its affiliate have filed a challenge to the jurisdiction of the British Columbia court. The plaintiff filed a motion for certification in April 2012, and filed affidavits in support in August 2013. An amended claim was filed in December 2014.

- In *McDermid v. Imperial Tobacco Canada Limited*, a case filed in June 2010 in the Supreme Court of British Columbia, Victoria Registry against Canadian and non-Canadian tobacco-related entities, including RJR Tobacco and one of its affiliates, the plaintiff, an individual smoker, alleging his own addiction and heart disease resulting from the use of tobacco products, is seeking compensatory and unspecified punitive damages on behalf of a proposed class comprised of all individuals, including their estates, who were alive on June 12, 2007, and who have suffered, or who currently suffer from heart disease, after having smoked a minimum of 25,000 cigarettes designed, manufactured, imported, marketed, or distributed by the defendants, as well as disgorgement of revenues earned by the defendants from January 1, 1954, to the date the claim was filed. RJR Tobacco and its affiliate have filed a challenge to the jurisdiction of the British Columbia court.

- In *Jacklin v. Canadian Tobacco Manufacturers' Council*, a case filed in June 2012 in the Ontario Superior Court of Justice, St. Catherines, against Canadian and non-Canadian tobacco-related entities, including RJR Tobacco and one of its affiliates, the plaintiff, an individual smoker, alleging her own addiction and chronic obstructive pulmonary disease resulting from the use of tobacco products, is seeking compensatory and unspecified punitive damages on behalf of a proposed class comprised of all individuals, including their estates, who were alive on June 12, 2007, and who have suffered, or who currently suffer from chronic obstructive pulmonary disease, heart disease, or cancer, after having smoked a minimum of 25,000 cigarettes designed, manufactured, imported, marketed, or distributed by the defendants, as well as restitution of profits, and reimbursement of government expenditure for health-care benefits allegedly caused by the use of tobacco products.

In each of these seven cases, the plaintiffs allege fraud, fraudulent concealment, breach of warranty, breach of warranty of merchantability and of fitness for a particular purpose, failure to warn, design defects, negligence, breach of a "special duty" to children and adolescents, conspiracy, concert of action, unjust enrichment, market share liability, joint liability, and violations of various trade practices and competition statutes. Pursuant to the terms of the 1999 sale of RJR Tobacco's international tobacco business, RJR Tobacco has tendered the defense of these seven actions to JTI. Subject to a reservation of rights, JTI has assumed the defense of RJR Tobacco and its current or former affiliates in these actions.

State Settlement Agreements — Enforcement and Validity; Adjustments

As of December 31, 2015, there were 27 cases concerning the enforcement, validity or interpretation of the State Settlement Agreements in which RJR Tobacco, B&W or Lorillard Tobacco is a party. This number includes those cases, discussed below, relating to disputed payments under the State Settlement Agreements.

In May 2006, the State of Florida filed a motion, in the Circuit Court of the Fifteenth Judicial Circuit, in and for Palm Beach County, Florida, to enforce the Florida Settlement Agreement, for an Accounting by Brown & Williamson Holdings, Inc., and for an Order of Contempt. The State asserts that B&W failed to report in its net operating profit on its shipments, cigarettes manufactured by B&W under contract for Star Tobacco or its parent, Star Scientific, Inc. The State is seeking approximately $12.4 million in additional payments under the Florida Settlement Agreement, as well as $17.0 million in interest payments. This matter is currently in the discovery phase.

NPM Adjustment Claims. The MSA includes an adjustment that potentially reduces the annual payment obligations of RJR Tobacco and the other PMs. Certain requirements, collectively referred to as the Adjustment Requirements, must be satisfied before the NPM Adjustment for a given year is available:

- an Independent Auditor must determine that the PMs have experienced a market share loss, beyond a triggering threshold, to those manufacturers that do not participate in the MSA, such non-participating manufacturers referred to as NPMs; and

- in a binding arbitration proceeding, a firm of independent economic consultants must find that the disadvantages of the MSA were a significant factor contributing to the loss of market share. This finding is known as a significant factor determination.

When the Adjustment Requirements are satisfied, the MSA provides that the NPM Adjustment applies to reduce the annual payment obligation of the PMs. However, an individual settling state may avoid its share of the NPM Adjustment if it had in place and diligently enforced during the entirety of the relevant year a "Qualifying Statute" that imposes escrow obligations on NPMs that are comparable to what the NPMs would have owed if they had joined the MSA. In such event, the state's share of the NPM Adjustment is reallocated to other settling states, if any, that did not have in place and diligently enforce a Qualifying Statute.

NPM Adjustment Claim for 2003. For 2003, the Adjustment Requirements were satisfied. As a result, in April 2006, RJR Tobacco placed approximately $647 million, and Lorillard Tobacco placed approximately $114 million, of its MSA payment into a disputed payments account, in accordance with a procedure established by the MSA. Such amounts represented RJR Tobacco's and Lorillard Tobacco's shares of the 2003 NPM Adjustment as calculated by the Independent Auditor. In March 2007, the Independent Auditor issued revised calculations that reduced RJR Tobacco's and Lorillard Tobacco's share of the NPM Adjustment for 2003 to approximately $615 million and $109 million, respectively. As a result, in April 2007, RJR Tobacco and Lorillard Tobacco instructed the Independent Auditor to release to the settling states approximately $32 million and $5 million, respectively, from the disputed payments account.

Following RJR Tobacco's payment of a portion of its 2006 MSA payment into the disputed payments account, 37 of the settling states filed legal proceedings in their respective MSA courts seeking declaratory orders that they diligently enforced their Qualifying Statutes during 2003 and/or orders compelling RJR Tobacco and the other PMs that placed money in the disputed payments account to pay the disputed amounts to the settling states. In response, RJR Tobacco and other PMs, pursuant to the MSA's arbitration provisions, moved to compel arbitration of the parties' dispute concerning the 2003 NPM Adjustment, including the states' diligent enforcement claims, before an arbitration panel consisting of three retired federal court judges. The settling states opposed these motions, arguing, among other things, that the issue of diligent enforcement must be resolved by MSA courts in each of the 52 settling states and territories.

Forty-seven of the 48 courts that addressed the question whether the dispute concerning the 2003 NPM Adjustment is arbitrable ruled that arbitration is required under the MSA. The Montana Supreme Court ruled that the State of Montana did not agree to arbitrate the question of whether it diligently enforced a Qualifying Statute. Subsequently, Montana and the PMs reached an agreement whereby the PMs agreed not to contest Montana's claim that it diligently enforced the Qualifying Statute during 2003.

In January 2009, RJR Tobacco and certain other PMs entered into an Agreement Regarding Arbitration, referred to as the Arbitration Agreement, with 45 of the MSA settling states (representing approximately 90% of the allocable share of the settling states) pursuant to which those states agreed to participate in a multistate arbitration of issues related to the 2003 NPM Adjustment. Under the Arbitration Agreement, the signing states had their ultimate liability, if any, with respect to the 2003 NPM Adjustment reduced by 20%, and RJR Tobacco and the other PMs that placed their share of the disputed 2005 NPM Adjustment (discussed below) into the disputed payments account, without releasing or waiving any claims, authorized the release of those funds to the settling states.

The arbitration panel contemplated by the MSA and the Arbitration Agreement, referred to as the Arbitration Panel, was selected, and proceedings before the panel with respect to the 2003 NPM Adjustment claim began in July 2010. Following the completion of document and deposition discovery, on November 3, 2011, RJR Tobacco and the other PMs advised the Arbitration Panel that they were not contesting the "diligent enforcement" of 12 states and the four U.S. territories with a combined allocable share of less than 14%. The "diligent enforcement" of the remaining 33 settling states, the District of Columbia and Puerto Rico was contested and became the subject of further proceedings. A common issues hearing was held in April 2012, and state specific evidentiary hearings with respect to the contested states were initiated.

As a result of the partial settlement of certain NPM Adjustment claims, as described in more detail below, as well as the earlier decisions not to contest the diligent enforcement of 12 states, two of which are participants in the partial settlement, and the four U.S. territories, only 15 contested settling states required state specific diligent enforcement rulings. State specific evidentiary hearings were completed as of the end of May 2013.

On September 11, 2013, the Arbitration Panel issued rulings with respect to the 15 remaining contested states. The Arbitration Panel ruled that six states (representing approximately 14.68% allocable share) — Indiana, Kentucky, Maryland, Missouri, New Mexico and Pennsylvania — had not diligently enforced their Qualifying Statutes in 2003. As a result of these rulings, it was expected that each of RJR Tobacco and Lorillard Tobacco was entitled to the maximum remaining amount with respect to its 2003 NPM Adjustment claim — approximately $266 million and $47 million, respectively, plus interest and earnings. All six states that were found "non-diligent" by the Arbitration Panel filed motions to vacate and/or modify the diligent enforcement rulings on the 2003 NPM Adjustment claim. The state courts in Pennsylvania and Missouri entered orders affecting the settlement payment calculations. Both courts modified the judgment reduction method that had been adopted by the Arbitration Panel, the effect of which was to reduce RJR Tobacco's and Lorillard Tobacco's recovery from these two states by a total of $75 million and $13 million, respectively. Similar motions filed by

Maryland were denied by its state court, and the State filed appeals. The orders in Pennsylvania and Missouri have been appealed by RJR Tobacco and the other PMs. On April 10, 2015, the intermediate appellate court in Pennsylvania upheld the trial court ruling modifying the judgment reduction method adopted by the Arbitration Panel. RJR Tobacco is appealing that ruling. On September 22, 2015, the intermediate appellate court in Missouri reversed the trial court ruling modifying the judgment reduction method adopted by the Arbitration Panel and reinstated the Panel's approach. Missouri is appealing that ruling. On October 2, 2015, the intermediate appellate court in Maryland reversed the trial court and modified the judgment reduction method adopted by the Arbitration Panel, the effect of which was to reduce RJR Tobacco's and Lorillard Tobacco's recovery from this state by a total of $21.2 million and $3.7 million, respectively. RJR Tobacco is appealing that ruling. The New Mexico trial court has not ruled on the motions filed by that state challenging the finding of non-diligence and seeking a modification of the judgment reduction method adopted by the Arbitration Panel.

Separately, two of the states found to be "non-diligent," Kentucky and Indiana, subsequently joined the partial settlement of certain NPM Adjustment claims, as described in more detail below. As a result, RJR Tobacco now estimates that the maximum remaining amount of its claim and Lorillard Tobacco's claim with respect to the 2003 NPM Adjustment claim is $197 million and $35 million, respectively, plus interest and earnings, and before reduction for the impact of the Pennsylvania and Maryland court orders.

In light of its joining the partial settlement, Indiana participated in a joint motion to stay indefinitely further proceedings on the motions it had filed to vacate the settlement and to modify the adverse diligent enforcement ruling against it. Similarly, Kentucky has joined in a stipulation by the parties filed with the court there to stay further proceedings on its motions, but that stipulation has not yet been signed by the court.

During 2015, RJR Tobacco reviewed the status of the various challenges filed by the non-diligent states to certain rulings of the Arbitration Panel. Three of the non-diligent states, Pennsylvania, Missouri and Maryland, are no longer challenging the findings of non-diligence entered against them by the Arbitration Panel. As a result, notwithstanding the orders entered by the trial courts in those three states that modified the judgment reduction method adopted by the Arbitration Panel to account for the partial settlement of certain NPM Adjustment claims and RJR Tobacco's pending appeals of those rulings, a certain portion of the potential recovery from these three states is now certain and can be estimated. Consequently, $93 million was recognized as a reduction of cost of products sold in RAI's consolidated statement of income for the year ended December 31, 2015. Until such time as the various remaining state motions challenging the rulings of the Arbitration Panel have been resolved, including any necessary appeals, uncertainty exists as to the timing, process and amount of RJR Tobacco's ultimate recovery with respect to its remaining share of the 2003 NPM Adjustment claim. Due to the uncertainty over the final resolution of these additional challenges impacting the remaining amount of RJR Tobacco's 2003 NPM Adjustment claim, no additional amounts resulting from the rulings of the Arbitration Panel for the remaining four non-diligent states have been recognized in RAI's consolidated financial statements as of December 31, 2015.

On February 8, 2016, Missouri joined the Term Sheet on a conditional basis. Missouri conditionally joined the Term Sheet on financial terms more favorable to the industry than those received by the original signatory states. Missouri's joinder is conditioned upon the enactment by the Missouri legislature of Allocable Share Repeal legislation in Missouri with an effective date making such legislation applicable to NPM cigarettes sold in Missouri beginning no later than August 28, 2016. If the condition is not satisfied by 15 days after the close of the current legislative session in Missouri, Missouri's conditional agreement to join the Term Sheet is terminated. Various provisions regarding the timing of credits to be received by RJR Tobacco and the other PMs and disbursements to the State from the Disputed Payments Account are also set forth in the conditional joinder.

NPM Adjustment Claims for 2004-2014. From 2006 to 2008, proceedings (including significant factor arbitrations before an independent economic consulting firm) were initiated with respect to the NPM Adjustment for 2004, 2005 and 2006. Ultimately, the Adjustment Requirements were satisfied with respect to each of these NPM Adjustments.

In June 2009, RJR Tobacco, certain other PMs and the settling states entered into an agreement with respect to the 2007, 2008 and 2009 significant factor determinations. This agreement provided that the settling states would not contest that the disadvantages of the MSA were "a significant factor contributing to" the market share loss experienced by the PMs in those years. The stipulation pertaining to each of the three years covered by the agreement became effective in February of the year a final determination by the firm of independent economic consultants would otherwise have been expected (2010, 2011 and 2012, respectively), if the issue had been arbitrated on the merits. RJR Tobacco and the PMs paid a total amount of $5 million into the States' Antitrust/Consumer Protection Tobacco Enforcement Fund established under Section VIII(c) of the MSA for each year

covered by that agreement, with RJR Tobacco paying approximately 47% of such amounts. On January 9, 2012, a new agreement with respect to significant factor determinations pertaining to 2010, 2011 and 2012 was entered into on terms essentially identical to the earlier agreement.

On May 19, 2015, a new agreement with respect to significant factor determinations pertaining to 2013 and 2014 was entered into on similar terms to the two earlier agreements, although the amount of the payment by RJR Tobacco and the other PMs for each year covered by the agreement was reduced from $5 million to $3.5 million. RJR Tobacco's and Lorillard Tobacco's shares of the payment pertaining to 2013 remained at approximately 47%, or $1.63 million, and approximately 20%, or $0.70 million, respectively.

Based on the payment calculations of the Independent Auditor and the agreement described above regarding the 2007, 2008 and 2009 significant factor determinations, the Adjustment Requirements have been satisfied with respect to the NPM Adjustments for 2007, 2008 and 2009. In addition, based on the payment calculations of the Independent Auditor and the agreement described above regarding the 2010, 2011 and 2012 significant factor determinations, the Adjustment Requirements have been satisfied with respect to the NPM Adjustment for 2010, 2011 and 2012. Finally, based on the payment calculations of the Independent Auditor and the agreement described above regarding the 2013 and 2014 significant factor determinations, the Adjustment Requirements have been satisfied with respect to the NPM Adjustment for 2013.

The approximate maximum principal amounts of RJR Tobacco's and Lorillard Tobacco's shares of the disputed NPM Adjustments for the years 2004 through 2014 (in millions), as currently calculated by the Independent Auditor, and the remaining amounts after the settlements of certain NPM Adjustments claims (see below), are as follows (1):

	RJR Tobacco		Lorillard Tobacco	
Volume Year	Disputed	Remaining after settlements	Disputed	Remaining after settlements
2004	$562	$210	$111	$41
2005	445	166	76	29
2006	419	156	73	27
2007	435	166	83	32
2008	468	179	104	40
2009	472	180	107	41
2010	470	179	119	46
2011	422	161	88	34
2012	429	163	97	38
2013	455	173	91	35
2014	433	165	93	36

(1) The amounts shown above do not include the interest or earnings thereon to which RJR Tobacco and Lorillard Tobacco believe they would be entitled to under the MSA.

In addition to the above, SFNTC's portion of the disputed NPM Adjustments for the years 2004 through 2014 is approximately $67 million and the remaining amount after the settlements is approximately $26 million.

Discussions have been underway with the jurisdictions that have not joined the Term Sheet, described below, to initiate arbitration proceedings with respect to the 2004 NPM Adjustment. On June 3, 2015, Philip Morris USA Inc. and 17 of the non-Term Sheet states executed a separate agreement that states that: (1) the parties to that agreement will arbitrate only one issue, diligent enforcement and any other issue to which Philip Morris USA Inc. and the 17 non-Term Sheet states jointly agree in the future may be included in the arbitration; and (2) issues between RJR Tobacco and Philip Morris USA Inc. that are necessary to determine the amount of the 2004 NPM Adjustment owed to each of them will not be included in that arbitration. In September 2015, RJR Tobacco filed motions in the 17 non-Term Sheet states that joined the agreement with Philip Morris USA Inc. to compel these states to arbitrate in a single arbitration all issues whose resolution is necessary for determining the amount (if any) that each of the PMs is entitled to receive in connection with the NPM Adjustment to their MSA payments for 2004. Philip Morris USA Inc. and the various states have filed cross-motions to compel seeking orders requiring RJR Tobacco to join the separate arbitration to which they have agreed. Courts in Colorado and Iowa have denied RJR Tobacco's motions to compel. Courts in Idaho, Utah, Rhode Island and Illinois have either granted or indicated they will grant relief to RJR Tobacco on the scope of arbitration and ordered the parties to negotiate further on arbitrator selection. Additional proceedings are pending.

Due to the uncertainty over the final resolution of the 2004-2014 NPM Adjustment claims asserted by RJR Tobacco, no assurances can be made related to the amounts, if any, that will be realized or any amounts (including interest) that will be owed, except as described below related to the partial settlement of certain NPM Adjustment claims.

Settlement/Partial Settlement of Certain NPM Adjustment Claims. On November 14, 2012, RJR Tobacco, certain other PMs and certain settling states entered into a Term Sheet that set forth terms on which accrued and potential NPM Adjustment claims for 2003 through 2014 could be resolved. The Term Sheet also set forth a restructured NPM Adjustment process to be applied on a going-forward basis, starting with the 2013 volume year. The Term Sheet was provided to all of the MSA settling states for their review and consideration. A total of 17 states, the District of Columbia and Puerto Rico, together representing just under 42% allocable share, joined the proposed settlement. RJR Tobacco and the other PMs indicated that they were prepared to go forward with the proposed settlement with that level of jurisdictional participation.

The Term Sheet provided that the Arbitration Panel in place to deal with the 2003 NPM Adjustment (and other NPM Adjustment-related matters) must review the proposed settlement and enter an appropriate order to confirm for the Independent Auditor that it should implement, as necessary, the terms of the settlement agreement.

On March 12, 2013, the Arbitration Panel entered a Stipulated Partial Settlement and Award, referred to as the Award, reflecting the financial terms of the Term Sheet. On March 29, 2013, the Independent Auditor issued a notice indicating that it intended to implement the financial provisions of the Term Sheet, and also issued various revised payment calculations pertaining to payment years 2009 through 2012 and final calculations pertaining to payment year 2013 that reflected implementation of the financial provisions of the Term Sheet.

On April 12, 2013, Oklahoma joined the Term Sheet, bringing to 20 the total number of jurisdictions that have joined the settlement, representing approximately 43% allocable share, and the Independent Auditor issued revised payment calculations reflecting the financial impact of Oklahoma's decision to join the settlement. Subsequently, on May 24, 2013, Connecticut and South Carolina also joined the Term Sheet bringing to 22 the total number of jurisdictions that have joined the settlement, representing approximately 46% allocable share. Efforts by two states, Colorado and Ohio, to obtain injunctions to prevent implementation of the Award were unsuccessful.

On June 10, 2014, Kentucky, and on June 26, 2014, Indiana, joined the Term Sheet, bringing to 24 the total number of jurisdictions that have joined the settlement, representing approximately 49.87% allocable share. These states, both of which were among the states found "non-diligent" by the Arbitration Panel, joined the Term Sheet on financial terms more favorable to RJR Tobacco and other PMs than those agreed to by the original signatory states.

On October 20, 2015, RJR Tobacco and certain other PMs (including SFNTC) entered into the NY Settlement Agreement with the State of New York to settle certain claims related to the MSA NPM Adjustment. The NY Settlement Agreement resolves NPM Adjustment claims related to payment years from 2004 through 2014 and puts in place a new method to determine future adjustments from 2015 forward as to New York. With the addition of New York's allocable share of 12.76%, RJR Tobacco has resolved the 2004 through 2014 NPM Adjustments with 25 jurisdictions, representing approximately 62.63% allocable share.

On February 8, 2016, Missouri joined the Term Sheet on a conditional basis. Missouri conditionally joined the Term Sheet on financial terms more favorable to the industry than those received by the original signatory states. Missouri's joinder is conditioned upon the enactment by the Missouri legislature of Allocable Share Repeal legislation in Missouri with an effective date making such legislation applicable to NPM cigarettes sold in Missouri beginning no later than August 28, 2016. If the condition is not satisfied by 15 days after the close of the current legislative session in Missouri, Missouri's conditional agreement to join the Term Sheet is terminated. Various provisions regarding the timing of credits to be received by RJR Tobacco and the other PMs and disbursements to the State from the Disputed Payments Account are also set forth in the conditional joinder.

For additional information related to the Term Sheet, the NY Settlement Agreement and the 2003 NPM Adjustment, see "— Cost of Products Sold" in note 1.

Other NPM Matters. Separately, on August 19, 2011, Idaho sent a letter on behalf of itself and 31 other states, stating their intent to initiate arbitration with respect to whether amounts used to measure the domestic cigarette market and to calculate PM payment obligations under the MSA should be the adjusted gross or the net number of cigarettes on which federal excise tax (including arbitrios de cigarillos) is paid. The parties also agreed to arbitrate the Independent Auditor's calculation of the volume adjustment with respect to the treatment of "roll

your own," referred to as RYO, tobacco. On January 21, 2013, the panel ruled that adjusted gross figures should be used in payment calculations and that, in the calculation of the volume adjustment, the Independent Auditor should use 0.0325 ounces of RYO tobacco to be the equivalent of one cigarette.

Other Litigation and Developments

JTI Claims for Indemnification. By a purchase agreement dated March 9, 1999, amended and restated as of May 11, 1999, referred to as the 1999 Purchase Agreement, RJR and RJR Tobacco sold its international tobacco business to JTI. Under the 1999 Purchase Agreement, RJR and RJR Tobacco retained certain liabilities relating to the international tobacco business sold to JTI. Under its reading of the indemnification provisions of the 1999 Purchase Agreement, JTI has requested indemnification for damages allegedly arising out of these retained liabilities. As previously reported, a number of the indemnification claims between the parties relating to the activities of Northern Brands in Canada have been resolved. The other matters for which JTI has requested indemnification for damages under the indemnification provisions of the 1999 Purchase Agreement are described below:

- In a letter dated March 31, 2006, counsel for JTI stated that JTI would be seeking indemnification under the 1999 Purchase Agreement for any damages it may incur or may have incurred arising out of a Southern District of New York grand jury investigation, a now-terminated Eastern District of North Carolina grand jury investigation, and various actions filed by the European Community and others in the U.S. District Court for the Eastern District of New York, referred to as the EDNY, against RJR Tobacco and certain of its affiliates on November 3, 2000, August 6, 2001, and (as discussed in greater detail below) October 30, 2002, and against JTI on January 11, 2002.
- JTI also has sought indemnification relating to a Statement of Claim filed on April 23, 2010, in the Ontario Superior Court of Justice, London, against JTI Macdonald Corp., referred to as JTI-MC, by the Ontario Flue-Cured Tobacco Growers' Marketing Board, referred to as the Board, Andy J. Jacko, Brian Baswick, Ron Kichler, and Aprad Dobrenty, proceeding on their own behalf and on behalf of a putative class of Ontario tobacco producers that sold tobacco to JTI-MC during the period between January 1, 1986 and December 31, 1996, referred to as the Class Period, through the Board pursuant to certain agreements. The Statement of Claim seeks recovery for damages allegedly incurred by the class representatives and the putative class for tobacco sales during the Class Period made at the contract price for duty free or export cigarettes with respect to cigarettes that, rather than being sold duty free or for export, purportedly were sold in Canada, which allegedly breached one or more of a series of contracts dated between June 4, 1986, and July 3, 1996. A motion to dismiss on the basis of statute of limitations was denied. An application requesting leave to appeal that decision was granted in April 2015. The appeal is pending.
- Finally, JTI has advised RJR and RJR Tobacco of its view that, under the terms of the 1999 Purchase Agreement, RJR and RJR Tobacco are liable for a roughly $1.85 million judgment entered in 1998, plus interest and costs, in an action filed in Brazil by Lutz Hanneman, a former employee of a former RJR Tobacco subsidiary. RJR and RJR Tobacco deny that they are liable for this judgment under the terms of the 1999 Purchase Agreement.

Although RJR and RJR Tobacco recognize that, under certain circumstances, they may have these and other unresolved indemnification obligations to JTI under the 1999 Purchase Agreement, RJR and RJR Tobacco disagree with JTI as to (1) what circumstances relating to any such matters may give rise to indemnification obligations by RJR and RJR Tobacco, and (2) the nature and extent of any such obligation. RJR and RJR Tobacco have conveyed their position to JTI, and the parties have agreed to resolve their differences at a later time.

European Community. On October 30, 2002, the European Community and ten of its member states filed a complaint in the U.S. District Court for the Eastern District of New York against RJR, RJR Tobacco and several currently and formerly related companies. The complaint contains many of the same or similar allegations found in an earlier complaint, now dismissed, filed in August 2001 and also alleges that the defendants, together with certain identified and unidentified persons, engaged in money laundering and other conduct violating civil RICO and a variety of common laws. The complaint also alleges that the defendants manufactured cigarettes that were eventually sold in Iraq in violation of U.S. sanctions. The plaintiffs seek compensatory, punitive and treble damages among other types of relief. This matter had been stayed and largely inactive until November 24, 2009, when, with the court's permission, the European Community and member states filed and served a second amended complaint. The second amended complaint added 16 member states as plaintiffs and RAI, RJR Tobacco

and R. J. Reynolds Global Products Inc., referred to as GPI, as defendants. The allegations contained in the second amended complaint are in most respects either identical or similar to those found in the prior complaint, but now add new allegations primarily regarding the activities of RAI, RJR Tobacco and GPI following the B&W business combination. Pursuant to a stipulation and order, the defendants filed a motion to dismiss the plaintiffs' second amended complaint on February 15, 2010. Ruling on part of the defendants' motion to dismiss, on March 8, 2011, the district court dismissed the plaintiffs' RICO claims, and reserved decision as to dismissal of the plaintiffs' state-law claims. Thereafter, on May 13, 2011, the district court granted the remaining portion of the defendants' motion and dismissed the plaintiffs' state-law claims based on the court's lack of subject matter jurisdiction. On May 16, 2011, the clerk of court entered a judgment dismissing the action in its entirety. On June 10, 2011, the plaintiffs filed a notice of appeal with the Second Circuit, appealing from the May 16, 2011, judgment, as well as the March 8, 2011, and May 13, 2011, orders that respectively resulted in the dismissal of their RICO and state-law claims.

On April 23, 2014, a three judge panel of the Second Circuit issued a decision on the appeal, and on April 29, 2014, a corrected decision was issued. The Second Circuit concluded that: (1) as pled, the RICO claims are within the scope of the RICO statute, and (2) the federal court does have subject matter jurisdiction over the state-law claims. Accordingly, the three judge panel of the Second Circuit decided that the judgment of the district court should be vacated, and the case remanded to the district court for further proceedings. On May 7, 2014, the defendants filed in the Second Circuit a petition for panel rehearing, or rehearing en banc, regarding the plaintiffs' RICO claims. On August 20, 2014, the three judge panel denied panel rehearing and issued an amended opinion that holds that a civil RICO cause of action extends to extraterritorial injuries. The amended opinion adheres to the three judge panel's April 23, 2014 ruling that the judgment of the district court should be vacated, and the case remanded to the district court for further proceedings. On April 13, 2015, the Second Circuit denied rehearing *en banc*. On July 27, 2015, the defendants filed a petition for writ of certiorari asking the U.S. Supreme Court to review the Second Circuit's decision to reinstate the RICO claims, and the district court has stayed further proceedings pending the disposition of that petition. On October 1, 2015, the U.S. Supreme Court granted certiorari to review the Second Circuit's decision. Briefing is ongoing, and a decision is expected by June 2016.

FDA Litigation. On February 25, 2011, RJR Tobacco, Lorillard and Lorillard Tobacco jointly filed a lawsuit, *Lorillard, Inc. v. U.S. Food and Drug Administration*, in the U.S. District Court for the District of Columbia, challenging the composition of TPSAC which had been established by the FDA under the Family Smoking Prevention and Tobacco Control Act, referred to as the FDA Tobacco Act. The complaint alleges that certain members of the TPSAC and certain members of its Constituents Subcommittee have financial and appearance conflicts of interest that are disqualifying under federal ethics law and regulations, and that the TPSAC is not "fairly balanced," as required by the Federal Advisory Committee Act, referred to as FACA. In March 2011, the plaintiffs filed an amended complaint, which added an additional claim, based on a nonpublic meeting of members of the TPSAC, in violation of the FACA. The court granted the plaintiffs' unopposed motion to file a second amended complaint adding a count addressing the FDA's refusal to produce all documents generated by the TPSAC and its subcommittee in preparation of the menthol report. On July 21, 2014, the court granted the plaintiffs' summary judgment motions finding that three members of the TPSAC Committee had impermissible conflicts of interest. As relief, the court ordered the FDA to reconstitute the committee in conformance with the law and enjoined the agency from using or relying on the TPSAC's 2011 Menthol Report. On September 18, 2014, the FDA appealed the decision to the D.C. Circuit. On January 15, 2016, the appellate court reversed the decision of the district court, finding that the plaintiffs did not have standing to challenge appointments of certain TPSAC members. Under the appellate court's order, the three former committee members can serve once again on the TPSAC and FDA can rely on the TPSAC menthol report. The plaintiffs have 45 days to seek a petition for rehearing or rehearing *en banc*.

On April 14, 2015, RJR Tobacco, American Snuff Co., SFNTC, Philip Morris USA Inc., U.S. Smokeless Tobacco Company LLC, and Lorillard Tobacco jointly filed a lawsuit in the U.S. District Court for the District of Columbia challenging the FDA's March 4, 2015 "guidance" document, "Guidance for Industry: Demonstrating the Substantial Equivalence of a New Tobacco Product: Responses to Frequently Asked Questions." The FDA's guidance attempted to require the FDA's prior approval for all changes to the label of a tobacco product that would render the product "distinct" and a "new tobacco product," even though there was no change to the product itself. Similarly, the FDA's guidance claims that prior approval would also be required for changes in the quantity of products sold within a package. The complaint alleged that the FDA's guidance was contrary to and exceeded the FDA's authority under the Federal Food, Drug, and Cosmetic Act ("FDCA"); violated First Amendment rights because it restricted and chilled protected commercial speech about tobacco products; and

was issued under the guise of "guidance" to avoid the notice-and-comment rulemaking requirements of the Administrative Procedure Act and the FDCA and subsequent judicial review. The plaintiffs requested that the court prevent the FDA from enforcing the guidance. On April 3, 2015, RAI Services Company, on behalf of RAI's above-mentioned operating companies, also filed comments with the FDA, explaining the reasons why the companies disagree with the guidance. In May 2015, the FDA adopted an "Interim Enforcement Policy," which stated that the FDA was considering regulatory comments and that it did not "intend to issue any warning letters or take steps to initiate any judicial or administrative adversarial proceedings" pursuant to its March 4, 2015 guidance during that period of review and consideration. Plaintiffs therefore dismissed the case without prejudice on June 2, 2015.

On September 8, 2015, the FDA issued a revised version of the same document entitled, "Guidance for Industry: Demonstrating the Substantial Equivalence of a New Tobacco Product: Responses to Frequently Asked Questions (Edition 2)." The revised version did not materially change the requirements set forth in the prior version regarding changes to product labels and changes to the quantity of products sold within a package. Accordingly, on September 30, 2015, RJR Tobacco, American Snuff Co., SFNTC, Philip Morris USA Inc., U.S. Smokeless Tobacco Company LLC, and Imperial Sub filed a lawsuit in the U.S. District Court for the District of Columbia challenging the FDA's September 8, 2015 "guidance" document. The September 30, 2015 complaint contains arguments and allegations that are substantially similar to those contained in the April 14, 2015 complaint. The plaintiffs have requested that the court prevent the FDA from enforcing the revised version of its guidance. On October 30, 2015, the plaintiffs filed a motion for summary judgment. On December 8, 2015, the government filed its opposition to the plaintiffs' motion for summary judgment as well as its own motion to dismiss or, in the alternative, motion for summary judgment. Briefing in the case will be completed on February 10, 2016.

For a detailed description of the FDA Tobacco Act, see "— Governmental Activity" in "Management's Discussion and Analysis of Financial Condition and Results of Operations," in Part I, Item 2.

Smokeless Tobacco Litigation

In 1999, when the IPIC litigation was first filed, the named defendants included manufacturers of smokeless products, including Conwood Company, LLC (now known as American Snuff Company, LLC) and others. When the IPIC plaintiffs filed discovery responses in IPIC listing the products they used, 41 of them listed a smokeless product. Six of those 41 plaintiffs listed a brand owned by American Snuff (Levi Garrett). Seven listed a brand (Beechnut) once manufactured by Lorillard Tobacco (now manufactured by National Tobacco Company). On December 3, 2001, the IPIC court severed all smokeless claims and all smokeless defendants from IPIC. There was no order staying the case during IPIC. In the ensuing 15 years, the plaintiffs in the severed cases did nothing to pursue the cases. During hearings in 2015 in the IPIC litigation, plaintiffs' counsel has suggested an intention to move forward with the severed smokeless claims. The defendants will object to any effort to activate these cases due to the fact that the plaintiffs took no action for the last 15 years.

Tobacco Buyout Legislation

In 2004, legislation was passed eliminating the U.S. Government's tobacco production controls and price support program. The buyout of tobacco quota holders provided for in the Fair and Equitable Tobacco Reform Act, referred to as FETRA, was funded by a direct quarterly assessment on every tobacco product manufacturer and importer, on a market-share basis measured on volume to which federal excise tax was applied. The aggregate cost of the buyout to the industry was approximately $9.9 billion, including approximately $9.6 billion payable to quota tobacco holders and growers through industry assessments over ten years, into 2014, and approximately $290 million for the liquidation of quota tobacco stock. RAI's operating subsidiaries recorded the FETRA assessment on a quarterly basis as cost of goods sold. RAI's operating subsidiaries' overall share of the buyout approximated $2.5 billion prior to the deduction of permitted offsets under the MSA. The FETRA assessment expired in September 2014.

ERISA Litigation

In May 2002, in *Tatum v. The R.J.R. Pension Investment Committee of the R. J. Reynolds Tobacco Company Capital Investment Plan*, an employee of RJR Tobacco filed a class-action suit in the U.S. District Court for the Middle District of North Carolina, alleging that the defendants, RJR, RJR Tobacco, the RJR Employee Benefits Committee and the RJR Pension Investment Committee, violated the Employee Retirement Income Security Act of 1974, referred to as ERISA. The actions about which the plaintiff complains stem from a decision made in 1999 by RJR Nabisco Holdings Corp., subsequently renamed Nabisco Group Holdings Corp., referred to as

NGH, to spin off RJR, thereby separating NGH's tobacco business and food business. As part of the spin-off, the 401(k) plan for the previously related entities had to be divided into two separate plans for the now separate tobacco and food businesses. The plaintiff contends that the defendants breached their fiduciary duties to participants of the RJR 401(k) plan when the defendants removed the stock funds of the companies involved in the food business, NGH and Nabisco Holdings Corp., referred to as Nabisco, as investment options from the RJR 401(k) plan approximately six months after the spin-off. The plaintiff asserts that a November 1999 amendment (the "1999 Amendment") that eliminated the NGH and Nabisco funds from the RJR 401(k) plan on January 31, 2000, contained sufficient discretion for the defendants to have retained the NGH and Nabisco funds after January 31, 2000, and that the failure to exercise such discretion was a breach of fiduciary duty. In his complaint, the plaintiff requests, among other things, that the court require the defendants to pay as damages to the RJR 401(k) plan an amount equal to the subsequent appreciation that was purportedly lost as a result of the liquidation of the NGH and Nabisco funds.

In July 2002, the defendants filed a motion to dismiss, which the court granted in December 2003. In December 2004, the U.S. Court of Appeals for the Fourth Circuit reversed the dismissal of the complaint, holding that the 1999 Amendment did contain sufficient discretion for the defendants to have retained the NGH and Nabisco funds as of February 1, 2000, and remanded the case for further proceedings. The court granted the plaintiff leave to file an amended complaint and denied all pending motions as moot. In April 2007, the defendants moved to dismiss the amended complaint. The court granted the motion in part and denied it in part, dismissing all claims against the RJR Employee Benefits Committee and the RJR Pension Investment Committee. The remaining defendants, RJR and RJR Tobacco, filed their answer and affirmative defenses in June 2007. The plaintiff filed a motion for class certification, which the court granted in September 2008. The district court ordered mediation, but no resolution of the case was reached. In September 2008, each of the plaintiffs and the defendants filed motions for summary judgment, and in January 2009, the defendants filed a motion to decertify the class. A second mediation occurred in June 2009, but again no resolution of the case was reached. The district court overruled the motions for summary judgment and the motion to decertify the class.

A non-jury trial was held in January and February 2010. During closing arguments, the plaintiff argued for the first time that certain facts arising at trial showed that the 1999 Amendment was not validly adopted, and then moved to amend his complaint to conform to this evidence at trial. On June 1, 2011, the court granted the plaintiff's motion to amend his complaint and found that the 1999 Amendment was invalid.

The parties filed their findings of fact and conclusions of law on February 4, 2011. On February 25, 2013, the district court dismissed the case with prejudice finding that a hypothetical prudent fiduciary could have made the same decision and thus the plan's loss was not caused by the procedural prudence which the court found to have existed. On March 8, 2013, the plaintiffs filed a notice of appeal. On August 4, 2014, the Fourth Circuit Court of Appeals, referred to as Fourth Circuit, reversed, holding that the district court applied the wrong standard when it held that the defendants did not cause any loss to the plan, determined the test was whether a hypothetical prudent fiduciary would have made the same decision and remanded the case back to the district court to apply the "would have standard." On December 1, 2014, the defendants filed a petition for writ of certiorari with the U.S. Supreme Court. On June 29, 2015, the U.S. Supreme Court denied the defendants' petition for writ of certiorari.

On November 19, 2014, the district court held a hearing and ordered briefing on various issues that remain pending on remand. The parties filed briefs addressing (1) the application of the different prudence standard, the "would have standard" adopted by the Fourth Circuit and (2) the merits of the defendants' affirmative defense related to releases executed by many class members and to the claims by class members who voluntarily sold their Nabisco shares while their accounts were frozen. The defendants also filed a renewed motion to decertify the class. The district court will address these pending motions in due course.

Environmental Matters

RAI and its subsidiaries are subject to federal, state and local environmental laws and regulations concerning the discharge, storage, handling and disposal of hazardous or toxic substances. Such laws and regulations provide for significant fines, penalties and liabilities, sometimes without regard to whether the owner or operator of the property or facility knew of, or was responsible for, the release or presence of hazardous or toxic substances. In addition, third parties may make claims against owners or operators of properties for personal injuries and property damage associated with releases of hazardous or toxic substances. In the past, RJR Tobacco has been named a potentially responsible party with third parties under the Comprehensive Environmental Response, Compensation and Liability Act with respect to several superfund sites. RAI and its

subsidiaries are not aware of any current environmental matters that are expected to have a material adverse effect on the business, results of operations or financial position of RAI or its subsidiaries.

RAI and its operating subsidiaries believe that climate change is an environmental issue primarily driven by carbon dioxide emissions from the use of energy. RAI's operating subsidiaries are working to reduce carbon dioxide emissions by minimizing the use of energy where cost effective, minimizing waste to landfills and increasing recycling. Climate change is not viewed by RAI's operating subsidiaries as a significant direct economic risk to their businesses, but rather an indirect risk involving the potential for a longer-term general increase in the cost of doing business. Regulatory changes are difficult to predict, but the current regulatory risks to the business of RAI's operating subsidiaries with respect to climate change are relatively low. Financial impacts will be driven more by the cost of natural gas and electricity. Efforts are made to anticipate the effect of increases in fuel costs directly impacting RAI's operating subsidiaries by evaluating natural gas usage and market conditions. Occasionally forward contracts are purchased, limited to a two-year period, for natural gas. In addition, RAI's operating subsidiaries are continually evaluating energy conservation measures and energy efficient equipment to mitigate impacts of increases in energy costs, and adopting or utilizing such measures and equipment where appropriate.

Regulations promulgated by the EPA and other governmental agencies under various statutes have resulted in, and likely will continue to result in, substantial expenditures for pollution control, waste treatment or handling, facility modification and similar activities. RAI and its subsidiaries are engaged in a continuing program to comply with federal, state and local environmental laws and regulations, and dependent upon the probability of occurrence and reasonable estimation of cost, accrue or disclose any material liability. Although it is difficult to reasonably estimate the portion of capital expenditures or other costs attributable to compliance with environmental laws and regulations, RAI does not expect such expenditures or other costs to have a material adverse effect on the business, results of operations, cash flows or financial position of RAI or its subsidiaries.

Shareholder Cases

Delaware. In the third quarter of 2014, Lorillard, the members of Lorillard's board of directors, RAI and BAT were named as defendants in 11 putative class action lawsuits brought in the Delaware Court of Chancery by Lorillard shareholders challenging the proposed Merger, referred to as the Delaware Actions. The complaints generally allege, among other things, that the members of the Lorillard board of directors breached their fiduciary duties to Lorillard shareholders by authorizing the Merger. The complaints also allege that RAI and BAT aided and abetted the breaches of fiduciary duties allegedly committed by the members of the Lorillard board of directors. On November 25, 2014, the court granted a motion for consolidation of the lawsuits into a single action captioned *In re Lorillard, Inc. Stockholders Litigation,* and for appointment of lead plaintiffs and lead counsel. On December 11, 2014, the lead plaintiffs filed a motion for a preliminary injunction and a motion to expedite.

Although they believe that these lawsuits are without merit and that no further disclosure was required to supplement the Joint Proxy Statement/Prospectus under applicable laws, to eliminate the burden, expense and uncertainties inherent in such litigation, on January 15, 2015, the defendants (other than BAT, which was not named in the amended complaint) entered into the Delaware Memorandum of Understanding regarding the settlement of the Delaware Actions. The Delaware Memorandum of Understanding outlines the terms of the parties' agreement in principle to settle and release all claims which were or could have been asserted in the Delaware Actions. In consideration for such settlement and release, the parties to the Delaware Actions agreed, among other things, that Lorillard and RAI would make certain supplemental disclosures to the Joint Proxy Statement/Prospectus, which they did on January 20, 2015. The Delaware Memorandum of Understanding contemplates that the parties will negotiate in good faith to agree upon a stipulation of settlement to be submitted to the court for approval as soon as practicable. The stipulation of settlement will be subject to customary conditions, including approval by the court, which will consider the fairness, reasonableness and adequacy of such settlement. There can be no assurance that the parties will ultimately enter into a stipulation of settlement or that the court will approve the settlement even if the parties were to enter into such a stipulation. In such event, the proposed settlement will be of no force and effect.

North Carolina. RAI, the members of the RAI board of directors and BAT have been named as defendants in a putative class action lawsuit captioned *Corwin v. British American Tobacco PLC, et al.*, brought in North Carolina state court, referred to as the North Carolina Action, by a person identifying himself as a shareholder of RAI. The North Carolina Action was initiated on August 8, 2014, and an amended complaint was filed on November 7, 2014. The amended complaint generally alleges, among other things, that the members of the RAI board of directors breached their fiduciary duties to RAI shareholders by approving the BAT Share Purchase and the sharing of technology with BAT. The amended complaint also alleges that there were various conflicts of

interest in the transaction, and that RAI aided and abetted the alleged breaches of fiduciary duties by its board of directors. The North Carolina Action seeks injunctive relief, damages and reimbursement of costs, among other remedies. On January 2, 2015, the plaintiff in the North Carolina Action filed a motion for a preliminary injunction seeking to enjoin temporarily the RAI shareholder meeting and votes scheduled for January 28, 2015. RAI and the RAI board of directors timely opposed that motion prior to a hearing that was scheduled to occur on January 16, 2015.

RAI believes that the North Carolina Action is without merit and that no further disclosure was necessary to supplement the Joint Proxy Statement/Prospectus under applicable laws. However, to eliminate certain burdens, expenses and uncertainties, on January 17, 2015, RAI and the director defendants in the North Carolina Action entered into the North Carolina Memorandum of Understanding regarding the settlement of the disclosure claims asserted in that lawsuit. The North Carolina Memorandum of Understanding outlines the terms of the parties' agreement in principle to settle and release the disclosure claims which were or could have been asserted in the North Carolina Action. In consideration of the partial settlement and release, RAI agreed to make certain supplemental disclosures to the Joint Proxy Statement/Prospectus, which it did on January 20, 2015. On August 4, 2015, the court granted the defendants' motions to dismiss all of the remaining non-disclosure claims. The plaintiff has appealed the dismissal. The hearing relating to the fairness of the partial settlement, including the plaintiff's unopposed request for $415,000 in attorneys' fees and costs, is scheduled for February 12, 2016. There can be no assurance that the court will approve the partial settlement. In the event the court does not approve the partial settlement, it will be null and void and of no force and effect. In addition, the partial settlement did not affect the consideration paid to Lorillard shareholders in connection with the Merger.

Other Contingencies

JTI Indemnities. In connection with the sale of the international tobacco business to JTI, pursuant to the 1999 Purchase Agreement, RJR and RJR Tobacco agreed to indemnify JTI against:

- any liabilities, costs and expenses arising out of the imposition or assessment of any tax with respect to the international tobacco business arising prior to the sale, other than as reflected on the closing balance sheet;
- any liabilities, costs and expenses that JTI or any of its affiliates, including the acquired entities, may incur after the sale with respect to any of RJR's or RJR Tobacco's employee benefit and welfare plans; and
- any liabilities, costs and expenses incurred by JTI or any of its affiliates arising out of certain activities of Northern Brands.

As described above in "— Litigation Affecting the Cigarette Industry — Other Litigation and Developments — JTI Claims for Indemnification," RJR Tobacco has received claims for indemnification from JTI, and several of these have been resolved. Although RJR and RJR Tobacco recognize that, under certain circumstances, they may have other unresolved indemnification obligations to JTI under the 1999 Purchase Agreement, RJR and RJR Tobacco disagree what circumstances described in such claims give rise to any indemnification obligations by RJR and RJR Tobacco and the nature and extent of any such obligation. RJR and RJR Tobacco have conveyed their position to JTI, and the parties have agreed to resolve their differences at a later date.

In connection with the sale of the international rights to the NATURAL AMERICAN SPIRIT brand name and associated trademarks to JTI Holding, along with the international companies that distribute and market the brand outside the United States, pursuant to the 2015 Purchase Agreement, SFNTC, R. J. Reynolds Global Products, Inc., and R. J. Reynolds Tobacco B.V. agreed to indemnify JTI Holding against, among other things, any liabilities, costs, and expenses relating to actions:

- commenced on or before (1) January 13, 2019, to the extent relating to alleged personal injuries, and (2) in all other cases, January 13, 2021;
- brought by (1) a governmental authority to enforce legislation implementing European Union Directive 2001/37/EC or European Directive 2014/40/EU or (2) consumers or a consumer association; and
- arising out of any statement or claim (1) made on or before January 13, 2016, (2) by any company sold to JTI Holding in the transaction, (3) concerning NATURAL AMERICAN SPIRIT brand products consumed or intended to be consumed outside of the United States and (4) that the NATURAL AMERICAN SPIRIT brand product is natural, organic, or additive free.

Indemnification of Distributors and Retailers. RJR Tobacco, Lorillard Tobacco, SFNTC, American Snuff Co. and RJR Vapor have entered into agreements to indemnify certain distributors and retailers from liability and

related defense costs arising out of the sale or distribution of their products. Additionally, SFNTC has entered into an agreement to indemnify a supplier from liability and related defense costs arising out of the sale or use of SFNTC's products. The cost has been, and is expected to be, insignificant. RJR Tobacco, SFNTC, American Snuff Co. and RJR Vapor believe that the indemnified claims are substantially similar in nature and extent to the claims that they are already exposed to by virtue of their having manufactured those products.

Imperial Sub Indemnity. In the Asset Purchase Agreement, RAI agreed to defend and indemnify, subject to certain conditions and limitations, Imperial Sub in connection with claims relating to the purchase or use of one or more of the WINSTON, KOOL, SALEM, or MAVERICK cigarettes brands on or before June 12, 2015, as well as in actions filed before June 13, 2023, relating to the purchase or use of one or more of the WINSTON, KOOL, SALEM, or MAVERICK cigarette brands. In the Asset Purchase Agreement, Imperial Sub agreed to defend and indemnify, subject to certain conditions and limitations, RAI and its affiliates in connection with claims relating to the purchase or use of blu brand e-cigarettes. Imperial Sub also agreed to defend and indemnify, subject to certain conditions and limitations, RAI and its affiliates in actions filed after June 12, 2023, relating to the purchase or use of one or more of the WINSTON, KOOL, SALEM, or MAVERICK cigarette brands after June 12, 2015.

Loews Indemnity. In 2008, Loews Corporation, referred to as Loews, entered into an agreement with Lorillard, Lorillard Tobacco, and certain of their affiliates, which agreement is referred to as the Separation Agreement. In the Separation Agreement, Lorillard agreed to indemnify Loews and its officers, directors, employees and agents against all costs and expenses arising out of third party claims (including, without limitation, attorneys' fees, interest, penalties and costs of investigation or preparation of defense), judgments, fines, losses, claims, damages, liabilities, taxes, demands, assessments, and amounts paid in settlement based on, arising out of or resulting from, among other things, Loews's ownership of or the operation of Lorillard and its assets and properties, and its operation or conduct of its businesses at any time prior to or following the separation of Lorillard and Loews (including with respect to any product liability claims). Loews is a defendant in three pending product liability actions, each of which is a putative class action. Pursuant to the Separation Agreement, Lorillard is required to indemnify Loews for the amount of any losses and any legal or other fees with respect to such cases. Following the closing of the Merger, RJR Tobacco assumed Lorillard's obligations under the Separation Agreement as was required under the Separation Agreement.

Except as otherwise noted above, RAI is not able to estimate the maximum potential amount of future payments, if any, related to these indemnification obligations.

Lease Commitments

RAI has operating lease agreements that are primarily for office space, automobiles, warehouse space and computer equipment. The majority of these leases expire within the next five years and some contain renewal or purchase options and escalation clauses or restrictions relating to subleases. Total rent expense was $26 million, $25 million and $24 million for 2015, 2014 and 2013, respectively.

Future minimum lease payments as of December 31, 2015 (in millions) were as follows:

	Noncancellable Operating Leases
2016	$19
2017	3
2018	2
2019	2
2020	2
Total	$28

Note 14 — Shareholders' Equity

RAI's authorized capital stock at December 31, 2015 and 2014, consisted of 100 million shares of preferred stock, par value $.01 per share, and 1.6 billion shares of common stock, par value $.0001 per share. Four million shares of the preferred stock are designated as Series A Junior Participating Preferred Stock, none of which is issued or outstanding. The Series A Junior Participating Preferred Stock will rank junior as to dividends and upon liquidation to all other series of RAI preferred stock, unless specified otherwise. Also, of the preferred stock, one million shares are designated as Series B Preferred Stock, all of which are issued and outstanding. The Series B

Preferred Stock ranks senior upon liquidation, but not with respect to dividends, to all other series of RAI capital stock, unless specified otherwise. As a part of the B&W business combination, RJR is the holder of the outstanding Series B Preferred Stock. In each of 2015, 2014 and 2013, RAI declared $43 million in dividends to RJR with respect to the Series B Preferred Stock.

In 2004, RAI's board of directors adopted a shareholder rights plan, pursuant to which RAI declared a dividend of one preferred stock purchase right on each share of RAI common stock outstanding on July 30, 2004. The rights plan expired in accordance with its terms on July 30, 2014.

RAI's board of directors declared the following quarterly cash dividends per share of RAI common stock in 2015, 2014 and 2013:

	2015	2014	2013
First	$0.335	$0.335	$0.295
Second	0.335	0.335	0.315
Third	0.360	0.335	0.315
Fourth	0.360	0.335	0.315

Accumulated Other Comprehensive Income (Loss)

The components of accumulated other comprehensive loss, net of tax, were as follows:

	Retirement Benefits	Unrealized Gain (Loss) on Long-Term Investments	Realized Loss on Hedging Instruments	Cumulative Translation Adjustment and Other	Total
Balance at December 31, 2013	$ (17)	$(16)	$(13)	$(10)	$ (56)
Other comprehensive income before reclassifications	(528)	2	—	(34)	(560)
Amounts reclassified from accumulated other comprehensive income (loss)	251	—	1	—	252
Net current-period other comprehensive income	(277)	2	1	(34)	(308)
Balance at December 31, 2014	(294)	(14)	(12)	(44)	(364)
Other comprehensive income before reclassifications	(78)	—	—	(25)	(103)
Amounts reclassified from accumulated other comprehensive income (loss)	128	—	1	—	129
Net current-period other comprehensive income	50	—	1	(25)	26
Balance at December 31, 2015	$(244)	$(14)	$(11)	$(69)	$(338)

Details about the reclassifications out of accumulated other comprehensive loss and the affected line items in the consolidated statements of income for the years ended December 31, 2015, 2014 and 2013, were as follows:

Components	Amounts Reclassified 2015	2014	2013	Affected Line Item
Defined benefit pension and postretirement plans:				
Amortization of prior service costs	$ (20)	$ (21)	$(21)	Cost of products sold
Amortization of prior service costs	(19)	(18)	(18)	Selling, general and administrative expenses
MTM adjustment	120	205	—	Cost of products sold
MTM adjustment	126	247	—	Selling, general and administrative expenses
	207	413	(39)	Operating income
Deferred taxes	(79)	(162)	16	Provision for income taxes
Net of tax	$128	$ 251	$(23)	Net income
Loss on hedging instruments:				
Amortization of realized loss	$ 2	$ 2	$ 2	Interest and debt expense
Deferred taxes	(1)	(1)	(1)	Provision for income taxes
Net of tax	$ 1	$ 1	$ 1	Net income
Total reclassifications	$129	$ 252	$(22)	Net income

Share Repurchases and Other

In November 2011, RAI, B&W and BAT entered into Amendment No. 3 to the governance agreement, pursuant to which RAI has agreed that, so long as the beneficial ownership interest of BAT and its subsidiaries in RAI has not dropped below 25%, if RAI issues shares of its common stock or any other RAI equity security to certain designated persons, including its directors, officers or employees, then RAI will repurchase a number of shares of outstanding RAI common stock so that the number of outstanding shares of RAI common stock are not increased, and the beneficial ownership interest of BAT and its subsidiaries in RAI is not decreased, by such issuance after taking into account such repurchase. During 2015, RAI repurchased and cancelled 1,820,453 shares of RAI common stock for $82 million in accordance with the governance agreement.

The RAI Long-Term Incentive Plan, a plan which expired in 2009, was replaced by the shareholder-approved Reynolds American Inc. 2009 Omnibus Incentive Compensation Plan as amended and restated and, approved by shareholders in 2014, referred to as the Omnibus Plan. Restricted stock units granted in March 2012, May 2014 and September 2014 under the Omnibus Plan vested in March 2015, May 2015 and September 2015, respectively, and were settled with the issuance of 2,870,927 shares of RAI common stock. In addition, during the year ended December 31, 2015, at a cost of $42 million, RAI purchased 1,111,835 shares of RAI common stock that were forfeited and cancelled with respect to tax liabilities associated with restricted stock units vesting under the Omnibus Plan.

Due to RAI's incorporation in North Carolina, which does not recognize treasury shares, the shares repurchased were cancelled at the time of repurchase.

Changes in RAI common stock outstanding were as follows:

	2015	2014	2013
Shares outstanding at beginning of year	1,062,567,026	1,076,106,048	1,105,881,534
Omnibus Plan tax shares repurchased and cancelled	(1,111,835)	(1,108,084)	(1,148,766)
Omnibus Plan shares issued from vesting of restricted stock units	2,870,927	2,936,588	3,144,778
Issuance of additional shares as Merger Consideration	209,413,694	—	—
Issuance of additional shares for BAT Share Purchase	155,360,518	—	—
Shares repurchased and cancelled	(1,822,197)	(15,431,526)	(31,834,348)
Equity incentive award plan shares issued	63,208	64,000	62,850
Shares outstanding at end of year	1,427,341,341	1,062,567,026	1,076,106,048

Note 15 — Stock Plans

As of December 31, 2015, RAI had two stock plans, the Equity Incentive Award Plan for Directors of RAI, referred to as the EIAP, and the Omnibus Plan.

Under the EIAP, RAI currently provides grants of deferred stock units to eligible directors on a quarterly and annual basis, with the annual grant being made generally on the date of RAI's annual shareholders' meeting. Prior to September 13, 2012, upon election to RAI's board of directors, an eligible director received an initial grant of 3,500 deferred stock units under the EIAP. After September 13, 2012, grants are no longer made to directors upon their initial election to the board of directors, but eligible directors initially elected to RAI's board of directors after such date on a date other than the annual meeting date, and who, therefore, are not eligible to receive the annual stock award for such year, now receive a pro rata portion of the annual award upon election. Directors may elect to receive shares of common stock in lieu of their initial and annual grants of deferred stock units. A maximum of 4,000,000 shares of common stock may be issued under this plan, of which 1,996,772 shares were available for grant as of December 31, 2015. Deferred stock units granted under the EIAP have a value equal to, and bear dividend equivalents at the same rate as, one share of RAI common stock, and have no voting rights. The dividends are paid as additional units in an amount equal to the number of shares of RAI common stock that could be purchased with the dividends on the date of payment. Generally, distribution of a director's deferred stock units will be made on January 2 following his or her last year of service on the board; however, for all grants made under the EIAP after December 31, 2007, a director may elect to receive his or her deferred stock units on the later of January 2 of a specified year or January 2 following his or her last year of service on the board. At the election of a director, distribution may be made in one lump sum or in up to ten annual installments. A director is paid in cash for the units granted quarterly and in common stock for the units granted initially and annually, unless the director elects to receive cash for the initial and annual grants. Cash payments are based on the average closing price of RAI common stock during December of the year preceding payment. Compensation expense related to the EIAP was $15 million, $10 million and $7 million during 2015, 2014 and 2013, respectively.

Awards to key employees under the Omnibus Plan may be in the form of cash awards, incentive or non-incentive stock options, stock appreciation rights, restricted stock, restricted stock units, performance shares, performance units or other awards. Subject to adjustments as set forth in the Omnibus Plan, the number of shares of RAI common stock that may be issued with respect to awards under the Omnibus Plan will not exceed 76,000,000 shares in the aggregate. Upon retirement, a holder's grant under the Omnibus Plan generally vests on a pro rata basis for the portion of the vesting service period that has elapsed, thereby maintaining an appropriate approximation of forfeitures related to retirement.

Information regarding restricted stock unit awards outstanding as of December 31, 2015, under the Omnibus Plan was as follows:

Grant Year	Number of Shares Granted	Grant Price Per Share	Vesting Date	Number of Shares Cancelled and Vested	Cumulative Dividends Per Share	Ending Date of Performance Period
Three-year grants						
2013	2,224,872	$21.680	March 1, 2016	429,892	$3.54	December 31, 2015
2014	2,098,696	$24.645	March 3, 2017	446,955	$4.02	December 31, 2016
2014	51,814	$29.365	March 3, 2017	—	$3.02	December 31, 2016
2015	1,386,180	$37.940	March 2, 2018	87,532	$4.02	December 31, 2017
2015	17,196	$36.300	March 2, 2018	—	$4.02	December 31, 2017
One-year grant						
2015	217,304	$46.150	May 7, 2016	—	$1.34	April 30, 2016
Other grants						
2014	41,451	$29.365	September 30, 2016	—	N/A	N/A
2014	74,266	$29.365	September 30, 2018	—	N/A	N/A

Three-Year Grants and Other Grants

The grant date fair value was based on the per share closing price of RAI common stock on the date of grant. The actual number of shares granted is fixed. The grants are accounted for as equity-based, and compensation expense includes the vesting period lapsed. There were no shares issued during 2015 with respect to awards outstanding as of December 31, 2015.

All outstanding grants will be settled exclusively in RAI common stock.

Upon settlement, each grantee of the three-year grants will receive a number of shares of RAI's common stock equal to the product of the number of vested units and a percentage up to 150% based on the average RAI annual incentive award plan score over the three-year period ending on December 31 of the year prior to the vesting date. The other grants do not contain a performance measure.

One-Year Grant

The actual number of shares granted is fixed. The grant is an equity-based grant where compensation expense will take into account the vesting period lapsed and will be calculated based on the per share closing price of RAI common stock as of the end of each quarter, which was $46.15 as of December 31, 2015. There were no shares issued during 2015 with respect to awards outstanding as of December 31, 2015. All outstanding grants will be settled exclusively in RAI common stock.

Upon settlement, the grantee will receive a number of shares of RAI's common stock equal to the product of the number of vested units and a percentage up to 200% based on the overall performance of RAI and its subsidiaries during the one-year performance period beginning May 1, 2015, and ending April 30, 2016, against RAI's 2015 annual incentive award program metrics and other performance factors.

Restricted Stock Unit Dividends

Dividends paid on shares of RAI common stock will accumulate on the restricted stock units and be paid to the grantee on the vesting date. If RAI fails to pay its shareholders cumulative dividends of at least the amounts shown above, then each award will be reduced by an amount equal to three times the percentage of the dividend underpayment, up to a maximum reduction of 50%. Dividends are accrued on the grants and included in other current liabilities, based on the vesting date of less than one year, and in other noncurrent liabilities, based on the vesting date of greater than one year, in the consolidated balance sheets as of December 31, 2015 and 2014.

The changes in the number of RAI restricted stock units during 2015 were as follows:

	Number of Stock Units	Weighted Average Grant Date Fair Value Per Share
Outstanding at beginning of year	6,038,436	$23.79
Granted	1,620,680	39.02
Forfeited	(190,743)	31.13
Vested	(2,320,973)	23.55
Outstanding at end of year	5,147,400	28.42

Total compensation expense related to stock-based compensation and the related tax benefits recognized in selling, general and administrative expenses in the consolidated statements of income as of December 31, were as follows:

Grant/Type	2015	2014	2013
2010 restricted stock units	$—	$—	$ 2
2011 restricted stock units	—	3	20
2012 restricted stock units	3	14	18
2013 restricted stock units	20	15	15
2014 restricted stock units	32	24	—
2015 restricted stock units	24	—	—
Total compensation expense	$79	$56	$55
Total related tax benefits	$28	$20	$19

The amounts related to the unvested Omnibus Plan restricted stock unit grants included in the consolidated balance sheets as of December 31, were as follows:

	2015	2014
Other current liabilities	$ 10	$ 9
Other noncurrent liabilities	8	8
Paid-in capital	110	99

As of December 31, 2015, there were $62 million of unrecognized compensation costs related to restricted stock units, calculated at the grant-date price, which are expected to be recognized over a weighted-average period of 1.72 years. The excess tax benefits related to stock-based compensation were $17 million, $12 million and $14 million in 2015, 2014 and 2013, respectively.

RAI has a policy of issuing new shares of common stock to satisfy share option exercises. There was no share option activity during 2015 and 2014.

Equity compensation plan information as of December 31, 2015, was as follows:

Plan Category	Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights	Weighted Average Exercise Price of Outstanding Options, Warrants and Rights	Number of Securities Remaining Available for Future Issuance under Equity Compensation Plans (Excluding Securities Reflected in Column (a))
	(a)	(b)	(c)
Equity Compensation Plans Approved by Security Holders	7,771,891 (2)	$—	62,644,502
Equity Compensation Plans Not Approved by Security Holders (1)	—	—	1,996,772
Total	7,771,891 (2)	—	64,641,274

(1) The EIAP was approved by RJR's sole shareholder, NGH, prior to RJR's spin-off on June 15, 1999.

(2) Consists of restricted stock units. These restricted stock units represent the maximum number of shares to be awarded under the best-case targets, and accordingly, may overstate expected dilution.

Note 16 — Retirement Benefits

RAI sponsors a number of non-contributory defined benefit pension plans covering most of the employees of RAI and certain of its subsidiaries. RAI and a subsidiary provide certain health and life insurance benefits for most of the retired employees of RAI and certain of its subsidiaries and their dependents. These benefits are generally no longer provided to employees hired on or after January 1, 2004.

The changes in benefit obligations and plan assets, as well as the funded status of these plans at December 31 were as follows:

	Pension Benefits		Postretirement Benefits	
	2015	2014	2015	2014
Change in benefit obligations:				
Obligations at beginning of year	$ 6,389	$ 5,618	$1,251	$1,169
Service cost	26	21	2	2
Interest cost	275	266	50	53
Actuarial (gain) loss	(270)	941	(120)	106
Merger	756	—	111	—
Benefits paid	(431)	(457)	(84)	(79)
Settlements	(7)	—	—	—
Obligations at end of year	$ 6,738	$ 6,389	$1,210	$1,251
Change in plan assets:				
Fair value of plan assets at beginning of year	$ 5,309	$ 5,220	$ 259	$ 268
Actual return on plan assets	(131)	536	(1)	14
Employer contributions	18	10	67	56
Merger	593	—	—	—
Benefits paid	(431)	(457)	(84)	(79)
Settlements	(7)	—	—	—
Fair value of plan assets at end of year	$ 5,351	$ 5,309	$ 241	$ 259
Funded status	$(1,387)	$(1,080)	$ (969)	$ (992)

For the pension benefit plans, the benefit obligation is the projected benefit obligation. For the postretirement benefit plans, the benefit obligation is the accumulated postretirement benefit obligation.

As of December 31, 2015, the decrease in the pension benefits funded status is primarily a result of the acquired plans from the Merger, lower return on plan assets, and updated assumptions which increased pension obligations by $17 million. The resulting decrease in funded status was offset by the increase in the discount rate. The increase in discount rate decreased pension obligations by $287 million.

As of December 31, 2015, the increase in postretirement benefits funded status is primarily a result of the increase in the discount rate and updated assumptions offset by the acquired plans from the Merger. The increase in the discount rate decreased postretirement obligations by $37 million and the updated assumptions decreased postretirement obligations by $83 million.

As of December 31, 2014, the decrease in pension and postretirement benefits funded status is primarily due to updated mortality assumptions and a decrease in the discount rate. The mortality assumptions were utilized to reflect the best estimate of future mortality for pension and postretirement plan participants. The result was an increase in pension and postretirement obligations of $381 million and $52 million, respectively.

	Pension Benefits		Postretirement Benefits	
	2015	2014	2015	2014
Amounts recognized in the consolidated balance sheets consist of:				
Accrued benefit — other current liabilities	$ (10)	$ (9)	$ (81)	$ (66)
Accrued benefit — long-term retirement benefits	(1,377)	(1,071)	(888)	(926)
Net amount recognized	(1,387)	(1,080)	(969)	(992)
Accumulated other comprehensive loss	636	652	(183)	(117)
Net amounts recognized in the consolidated balance sheets	$ (751)	$ (428)	$(1,152)	$(1,109)

Amounts included in accumulated other comprehensive loss were as follows as of December 31:

	2015			2014		
	Pension Benefits	Postretirement Benefits	Total	Pension Benefits	Postretirement Benefits	Total
Prior service cost (credit)	$ 10	$(137)	$(127)	$ 14	$(178)	$(164)
Net actuarial (gain) loss	626	(46)	580	638	61	699
Deferred income taxes	(262)	53	(209)	(268)	27	(241)
Accumulated other comprehensive loss	$ 374	$(130)	$ 244	$ 384	$ (90)	$ 294

Changes in accumulated other comprehensive loss were as follows:

	2015			2014		
	Pension Benefits	Postretirement Benefits	Total	Pension Benefits	Postretirement Benefits	Total
Net actuarial (gain) loss	$ 234	$(107)	$ 127	$ 764	$104	$ 868
Amortization of prior service cost (credit)	(3)	42	39	(3)	42	39
Prior service cost (credit)	—	(1)	(1)	—	—	—
Settlements	(1)	—	(1)	—	—	—
MTM adjustment	(246)	—	(246)	(420)	(32)	(452)
Deferred income tax (benefit) expense	6	26	32	(134)	(44)	(178)
Change in accumulated other comprehensive loss	$ (10)	$ (40)	$ (50)	$ 207	$ 70	$ 277

The MTM adjustment in 2015 is primarily a result of pension asset return losses of $131 million versus an expected return of $373 million and was partially offset by an increase in the discount rate. The MTM adjustment in 2014 is primarily a result of updated mortality assumptions which increased pension obligations by $381 million and postretirement obligations by $52 million.

In March 2010, the Patient Protection Affordable Care Act, referred to as the PPACA, as amended by the Health Care and Reconciliation Act of 2010, was signed into law. The PPACA mandates health-care reforms

with staggered effective dates from 2010 to 2018. The additional postretirement liability resulting from the material impacts of the PPACA have been included in the accumulated postretirement benefit obligation at December 31, 2015 and 2014. Given the complexity of the PPACA and the extended time period in which implementation is expected to occur, further adjustments to the accumulated postretirement benefit obligation may be necessary in the future.

	Pension Benefits		Postretirement Benefits	
	2015	2014	2015	2014
Weighted-average assumptions used to determine benefit obligations at December 31:				
Discount rate	4.54%	4.12%	4.47%	4.11%
Rate of compensation increase	4.00%	4.00%	—	—

The measurement date used for all plans was December 31.

Pension plans experiencing accumulated benefit obligations, which represent benefits earned to date, in excess of plan assets are summarized below:

	December 31,	
	2015	2014
Projected benefit obligation	$6,738	$6,389
Accumulated benefit obligation	6,684	6,326
Plan assets	5,351	5,309

The components of the total benefit cost (income) and assumptions are set forth below:

	Pension Benefits			Postretirement Benefits		
	2015	2014	2013	2015	2014	2013
Service cost	$ 26	$ 21	$ 23	$ 2	$ 2	$ 3
Interest cost	275	266	247	50	53	50
Expected return on plan assets	(373)	(360)	(350)	(12)	(12)	(11)
Amortization of prior service cost (credit)	3	3	3	(42)	(42)	(42)
Settlements	1	—	—	—	—	—
MTM adjustment	246	420	—	—	32	—
Total benefit cost (income)	$ 178	$ 350	$ (77)	$ (2)	$ 33	$ —

The estimated prior service cost for the pension plans that is expected to be amortized from accumulated other comprehensive loss into net periodic benefit cost during 2016 is $3 million. The estimated prior service credit for the postretirement plans that is expected to be amortized from accumulated other comprehensive loss into net periodic benefit cost during 2016 is $42 million.

	Pension Benefits			Postretirement Benefits		
	2015	2014	2013	2015	2014	2013
Weighted-average assumptions used to determine net periodic benefit cost for years ended December 31: (1)						
Discount rate	4.14%	4.92%	4.07%	4.12%	4.87%	3.99%
Expected long-term return on plan assets	6.83%	7.13%	6.67%	4.85%	4.85%	4.35%
Rate of compensation increase	4.00%	4.00%	4.00%	—	—	—

(1) Determined as of the beginning of year and adjusted for the Merger.

RAI generally uses a hypothetical bond matching analysis to determine the discount rate. The discount rate modeling process involves selecting a portfolio of high quality corporate bonds whose cash flows, via coupons and maturities, match the projected cash flows of the obligations.

The overall expected long-term rate of return on asset assumptions for pension and postretirement assets are based on: (1) the target asset allocation for plan assets, (2) long-term capital markets forecasts for asset classes employed, and (3) excess return expectations of active management to the extent asset classes are actively managed.

Plan assets are invested using active investment strategies and multiple investment management firms. Managers within each asset class cover a range of investment styles and approaches and are combined in a way that controls for capitalization, style biases, and interest rate exposures, while focusing primarily on security selection as a means to add value. Risk is controlled through diversification among asset classes, managers,

styles and securities. Risk is further controlled both at the manager and asset class level by assigning excess return and tracking error targets against related benchmark indices. Investment manager performance is evaluated against these targets.

RAI's risk mitigation strategy seeks to balance pension plan returns with a reasonable level of funded status volatility. Based on this framework, the asset allocation has two primary components. The first component is the "hedging portfolio", which uses extended duration fixed income holdings and derivatives to match a portion of the interest rate risk associated with the benefit obligations, thereby reducing expected funded status volatility. The second component is the "return seeking portfolio", which is designed to enhance portfolio returns. The return seeking portfolio is broadly diversified across asset classes.

Allowable investment types include domestic equity, international equity, global equity, emerging market equity, fixed income, real assets, private equity, absolute return and commodities. The range of allowable investment types utilized for pension assets provides enhanced returns and more widely diversifies the plan. Domestic equities are composed of common stocks of large, medium and small companies. International equities include equity securities issued by companies domiciled outside the United States and in depository receipts, which represent ownership of securities of non-U.S. companies. Global equities include a combination of both domestic and international equities. Emerging market equities are comprised of stocks that are domiciled in less developed, fast growing countries. Fixed income includes corporate debt obligations, fixed income securities issued or guaranteed by the U.S. government, and to a lesser extent by non-U.S. governments, mortgage backed securities, high yield securities, asset backed securities, municipal bonds and dollar-denominated obligations issued in the United States by non-U.S. banks and corporations. Real assets consist of publicly traded real estate investment trust securities, private real estate investments and private energy investments. Private equity consists of the unregistered securities of private and public companies. Absolute return investments are diversified portfolios utilizing multiple strategies that invest primarily in public securities, including equities and fixed income. Commodities utilize futures contracts to invest in a variety of energy, metal and agricultural goods.

For pension assets, futures and forward contracts are used for portfolio rebalancing and to approach fully invested portfolio positions. Otherwise, a small number of investment managers employ limited use of derivatives, including futures contracts, options on futures, forward contracts and interest rate swaps in place of direct investment in securities to gain efficient exposure to markets.

RAI's pension and postretirement plans asset allocations at December 31, 2015 and 2014, by asset category were as follows:

	Pension Plans			
	2015 Target (1)	2015	2014 Target (1)	2014
Asset Category:				
Domestic equities	10%	10%	10%	10%
International equities	8%	7%	8%	8%
Global equities	9%	11%	9%	10%
Emerging market equities	3%	2%	3%	3%
Fixed income	53%	53%	53%	56%
Absolute return	6%	8%	6%	4%
Private equity	2%	2%	2%	1%
Real assets	5%	5%	5%	4%
Commodities	4%	2%	4%	4%
Total	100%	100%	100%	100%

	Postretirement Plans			
	2015 Target (1)	2015	2014 Target (1)	2014
Asset Category:				
Domestic equities	21%	20%	21%	21%
International equities	21%	21%	21%	20%
Fixed income	55%	54%	55%	54%
Cash and other	3%	5%	3%	5%
Total	100%	100%	100%	100%

(1) Allows for a rebalancing range of up to 5 percentage points around target asset allocations.

RAI's pension and postretirement plan assets, excluding uninvested cash and unsettled trades, carried at fair value on a recurring basis as of December 31, 2015 and 2014, were as follows (1):

	2015				2014			
Pension Plans	**Level 1**	**Level 2**	**Level 3**	**Total**	**Level 1**	**Level 2**	**Level 3**	**Total**
Asset Category:								
Domestic equities	$ 410	$ 47	$ —	$ 457	$ 511	$ —	$ —	$ 511
International equities	144	232	—	376	134	172	—	306
Global equities	585	28	—	613	570	—	—	570
High yield fixed income	—	19	—	19	—	19	—	19
Absolute return	—	177	345	522	—	126	223	349
Private equity	—	—	106	106	—	—	66	66
Real assets	21	6	204	231	21	—	188	209
Commodities	—	57	—	57	—	156	—	156
Agency bonds	—	18	—	18	—	21	—	21
Asset backed securities	—	89	3	92	—	93	3	96
Corporate bonds	—	1,718	1	1,719	—	1,739	2	1,741
Government bonds	—	91	—	91	—	153	—	153
Mortgage backed securities	—	41	24	65	—	42	25	67
Municipal bonds	—	201	—	201	—	209	—	209
Emerging market equities	—	57	—	57	—	52	—	52
Treasuries	—	550	—	550	—	414	—	414
Other	33	90	2	125	62	101	2	165
Total	$1,193	$3,421	$685	$5,299	$1,298	$3,297	$509	$5,104

	2015				2014			
Postretirement Plans	**Level 1**	**Level 2**	**Level 3**	**Total**	**Level 1**	**Level 2**	**Level 3**	**Total**
Asset Category:								
Domestic equities	$—	$ 49	$—	$ 49	$—	$ 55	$—	$ 55
International equities	—	49	—	49	—	50	—	50
Short-term bonds	13	—	—	13	9	—	—	9
Intermediate bonds	—	118	—	118	—	131	—	131
Other	—	6	—	6	—	7	—	7
Total	$13	$222	$—	$235	$ 9	$243	$—	$252

(1) See note 1 for additional information on the fair value hierarchy.

Transfers of pension and postretirement plan assets in and out of Level 3 during 2015, by asset category were as follows:

	Balance as of January 1, 2015	Purchases, Sales, Issuances and Settlements (net)	Realized Gains	Unrealized Gains (Losses)	Transferred From Other Levels	Balance as of December 31, 2015
Absolute return	$223	$122	$ 1	$ (1)	$—	$345
Private equity	66	32	10	(2)	—	106
Real assets	188	(4)	12	8	—	204
Asset backed securities	3	—	—	—	—	3
Corporate bonds	2	(1)	—	—	—	1
Mortgage backed securities	25	(1)	—	—	—	24
Other	2	—	—	—	—	2
Total	$509	$148	$23	$ 5	$—	$685

Transfers of pension and postretirement plan assets in and out of Level 3 during 2014, by asset category were as follows:

	Balance as of January 1, 2014	Purchases, Sales, Issuances and Settlements (net)	Realized Gains	Unrealized Gains (Losses)	Transferred From Other Levels	Balance as of December 31, 2014
Absolute return	$176	$ 40	$13	$ (6)	$—	$223
Private equity	53	6	7	—	—	66
Real assets	190	(24)	8	14	—	188
Asset backed securities	3	—	—	—	—	3
Corporate bonds	2	—	—	—	—	2
Mortgage backed securities	21	2	1	1	—	25
Other	2	—	—	—	—	2
Total	$447	$ 24	$29	$ 9	$—	$509

For the years ended December 31, 2015 and 2014, there were no changes among the fair value hierarchy levels between Level 1 and Level 2.

At December 31, 2015 and 2014, the fair value of pension and postretirement assets classified as Level 2 or Level 3 was determined using a combination of third party pricing services and net asset value. In instances where the plans have invested in commingled pools, the net asset value was used as the practical expedient and no adjustments were made to the provided fair value.

The fair value of commingled pools classified as commodities, emerging market equities, municipal bonds, high yield fixed income, mortgage backed securities, domestic equities, international equities, intermediate bonds, other and certain of those classified as real assets, asset backed securities and absolute return, classified as Level 2 and Level 3, was determined primarily using an income approach. This approach utilized the net asset value of the underlying investment fund adjusted by the investment manager for restrictions or illiquidity of the disposition of the interest, if any, valuations provided by the fund's cash flows, and the rights and obligations of the ownership interest of the fund.

The fair value of assets classified as private equity and certain of those classified as real assets and absolute return, classified as Level 3, was determined primarily using an income approach. The fair value was determined by qualified appraisers utilizing observable and unobservable data, including comparable transactions, the fair value of the underlying assets, discount rates, restrictions on disposing interests in the investment's cash flows and other entity specific risk factors.

The fair value of assets classified as corporate bonds, other and certain of those classified as asset backed securities, classified as Level 3, was determined primarily using an income approach that utilized cash flow models and benchmarking strategies. This approach utilized observable inputs, including market-based interest rate curves, corporate credit spreads and corporate ratings. Additionally, unobservable factors incorporated into these models included default probability assumptions, potential recovery and discount rates.

Additional information relating to RAI's significant postretirement plans is as follows:

	2015	2014
Weighted-average health-care cost trend rate assumed for the following year	7.00%	7.25%
Rate to which the cost trend rate is assumed to decline (the ultimate trend rate)	5.00%	5.00%
Year that the rate reaches the ultimate trend rate	2020	2020

Assumed health-care cost trend rates have a significant effect on the amounts reported for the health-care plans. A one-percentage-point change in assumed health-care cost trend rates would have had the following effects at December 31, 2015:

	1-Percentage Point Increase	1-Percentage Point Decrease
Effect on total of service and interest cost components	$ 2	$ (2)
Effect on benefit obligation	62	(52)

During 2016, RAI expects to contribute $335 million to its pension plans, of which $325 million was contributed in January 2016. During 2016, RAI expects payments related to its postretirement plans to be approximately $81 million.

Estimated future benefit payments:

		Postretirement Benefits		
Year	Pension Benefits	Gross Projected Benefit Payments Before Medicare Part D Subsidies	Expected Medicare Part D Subsidies	Net Projected Benefit Payments After Medicare Part D Subsidies
2016	$ 454	$110	$ (2)	$108
2017	448	96	(2)	94
2018	444	93	(2)	91
2019	441	90	(2)	88
2020	437	87	(2)	85
2021-2025	2,122	405	(13)	392

Defined Contribution Plans

RAI sponsors qualified defined contribution plans. The expense related to these plans was $40 million in 2015, $37 million in 2014 and $34 million in 2013. Included in the plans is a non-leveraged employee stock ownership plan, which holds shares of the Reynolds Stock Fund. Participants can elect to contribute to the fund. Dividends paid on shares are reflected as a reduction of equity. All shares are considered outstanding for earnings per share computations.

Note 17 — Segment Information

RAI's reportable operating segments are RJR Tobacco, Santa Fe and American Snuff. The RJR Tobacco segment consists principally of the primary operations of R. J. Reynolds Tobacco Company. The Santa Fe segment consists of the domestic operations of SFNTC. The American Snuff segment consists of the primary operations of American Snuff Co. Included in All Other, among other RAI subsidiaries, are RJR Vapor, Niconovum USA, Inc., Niconovum AB, and until their sale on January 13, 2016, SFRTI and various foreign subsidiaries affiliated with SFRTI. The segments were identified based on how RAI's chief operating decision maker allocates resources and assesses performance. Certain of RAI's operating subsidiaries have entered into intercompany agreements for products or services with other subsidiaries. As a result, certain activities of an operating subsidiary may be included in a different segment of RAI.

RAI's largest reportable operating segment, RJR Tobacco, is the second largest tobacco company in the United States. RJR Tobacco's brands include three of the best-selling cigarettes in the United States: NEWPORT, CAMEL and PALL MALL. These brands, and its other brands, including DORAL, MISTY and CAPRI, are manufactured in a variety of styles and marketed in the United States. As part of its total tobacco strategy, RJR Tobacco also offers a smoke-free tobacco product, CAMEL Snus. RJR Tobacco manages contract manufacturing of cigarette and tobacco products through arrangements with BAT affiliates, and manages the export of tobacco products to certain U.S. territories, U.S. duty-free shops and U.S. overseas military bases. RJR Tobacco manages the super-premium cigarettes, DUNHILL and STATE EXPRESS 555, which are licensed from BAT.

Santa Fe manufactures and markets super-premium cigarettes and other tobacco products under the NATURAL AMERICAN SPIRIT brand in the United States.

American Snuff is the second largest smokeless tobacco products manufacturer in the United States. American Snuff's primary brands include its largest selling moist snuff brands, GRIZZLY and KODIAK.

RJR Vapor is a manufacturer and marketer of digital vapor cigarettes under the VUSE brand name in the United States. Niconovum USA, Inc. and Niconovum AB are marketers of nicotine replacement therapy products in the United States and Sweden, respectively, under the ZONNIC brand name.

SFRTI and various foreign subsidiaries affiliated with SFRTI distribute the NATURAL AMERICAN SPIRIT brand outside the United States. On January 13, 2016, RAI, through the Sellers, completed the sale of the international rights to the NATURAL AMERICAN SPIRIT brand name and associated trademarks, along with the international companies that distribute and market the brand outside the United States to JTI Holding, a subsidiary of JTI, in an all-cash transaction with a value of approximately $5 billion.

Intersegment revenues and items below the operating income line of the consolidated statements of income are not presented by segment, since they are excluded from the measure of segment profitability reviewed by RAI's chief operating decision maker. Additionally, information about total assets by segment is not reviewed by RAI's chief operating decision maker and therefore is not disclosed.

Segment Data:

	2015	2014	2013
Net sales:			
RJR Tobacco	$ 8,634	$6,767	$6,728
Santa Fe	818	658	572
American Snuff	855	783	745
All Other	368	263	191
Consolidated net sales	$10,675	$8,471	$8,236
Operating income (loss):			
RJR Tobacco (1)(2)(3)	$ 3,359	$2,173	$2,587
Santa Fe (4)	449	337	280
American Snuff (3)	502	438	420
All Other (5)	(265)	(234)	(70)
Gain on Divestiture	3,181	—	—
Corporate Expense (3)	(273)	(183)	(85)
Consolidated operating income	$ 6,953	$2,531	$3,132
Cash capital expenditures:			
RJR Tobacco	$ 84	$ 53	$ 55
Santa Fe	16	7	2
American Snuff	10	12	15
All Other	64	132	81
Consolidated capital expenditures	$ 174	$ 204	$ 153
Depreciation and amortization expense:			
RJR Tobacco	$ 71	$ 65	$ 68
Santa Fe	3	3	3
American Snuff	17	17	18
All Other	31	21	14
Consolidated depreciation and amortization expense	$ 122	$ 106	$ 103
Reconciliation to income from continuing operations before income taxes:			
Consolidated operating income (1)(2)(3)(4)(5)	$ 6,953	$2,531	$3,132
Interest and debt expense	570	286	259
Interest income	(6)	(3)	(5)
Other (income) expense, net	5	(14)	137
Income from continuing operations before income taxes	$ 6,384	$2,262	$2,741

(1) Includes trademark and/or other intangible asset impairment charges of $32 million for the year ended December 31, 2013, see "Intangible Assets" in note 4.

(2) Includes NPM Adjustment credits of $293 million, $341 million and $478 million for RJR Tobacco for the years ended December 31, 2015, 2014 and 2013, respectively. In addition, 2015 includes $93 million for the partial recognition of the 2003 NPM Adjustment. See "— Cost of Products Sold" in note 1.

(3) Includes MTM adjustment of $229 million for RJR Tobacco, $1 million for American Snuff and $16 million for Corporate Expense for the year ended December 31, 2015. Includes MTM adjustment of $422 million for RJR Tobacco, $4 million for American Snuff and $26 million for Corporate Expense for the year ended December 31, 2014.

(4) Includes NPM Adjustment credits of $4 million, $4 million and $5 million for Santa Fe for the years ended December 31, 2015, 2014 and 2013, respectively, see "— Cost of Products Sold" in note 1.

(5) Includes a $99 million charges for asset impairment and exit charges for the year ended December 31, 2015, see "Asset Impairment" in note 5.

Sales to McLane Company, Inc., a distributor, constituted approximately 28% of RAI's consolidated revenue in 2015 and approximately 31% in each of 2014 and 2013. Sales to Core-Mark International, Inc., a distributor, represented approximately 10% of RAI's consolidated revenue in 2015 and approximately 11% in

each of 2014 and 2013. McLane Company, Inc. and Core-Mark International, Inc. are customers of RJR Tobacco, Santa Fe and American Snuff. No other customer accounted for 10% or more of RAI's consolidated revenue during those periods.

RAI's operating subsidiaries' sales to foreign countries, primarily to related parties, for the years ended December 31, 2015, 2014 and 2013 were $482 million, $497 million and $496 million, respectively.

Note 18 — Related Party Transactions

RAI and RAI's operating subsidiaries engage in transactions with affiliates of BAT. BAT, through wholly owned subsidiaries, owns approximately 42% of RAI's outstanding common stock. The following is a summary of balances and transactions with such BAT affiliates as of and for the years ended December 31:

Balances:

	2015	2014
Accounts receivable, related party	$38	$41
Due to related party	9	1
Deferred revenue, related party	33	32
Other current liabilities	2	—

Significant transactions:

	2015	2014	2013
Net sales	$ 259	$311	$337
Purchases	38	28	27
BAT Share Purchase	4,673	—	—
RAI common stock purchases from B&W	—	155	296
Capsule royalty income	—	7	9
Research and development services billings	3	4	4

RJR Tobacco sells contract-manufactured cigarettes, tobacco leaf and processed tobacco to BAT affiliates. In December 2012, RJR Tobacco entered into an amendment to its contract manufacturing agreement (relating to the production of cigarettes to be sold in Japan) with a BAT affiliate, which amendment, among other things, requires either party to provide three years' notice to the other party to terminate the agreement without cause, with any such notice to be given no earlier than January 1, 2016. On January 4, 2016, RJR Tobacco received written notice from a BAT affiliate terminating that contract manufacturing agreement effective January 5, 2019. Net sales to BAT affiliates, primarily cigarettes, represented approximately 2% of RAI's total net sales in 2015, and 4% in each of 2014 and 2013.

RJR Tobacco recorded deferred sales revenue relating to leaf sold to BAT affiliates that had not been delivered as of December 31, in each of 2015, 2014 and 2013, given that RJR Tobacco has a legal right to bill the BAT affiliates. Leaf sales revenue to BAT affiliates is recognized when the product is shipped to the customer. RJR Tobacco recorded royalty income from the license of capsule technology to BAT affiliates.

RJR Tobacco performs certain research and development for BAT affiliates pursuant to a joint technology sharing agreement entered into as a part of the B&W business combination. These services were billed to BAT affiliates and were recorded in RJR Tobacco's selling, general and administrative expenses, net of associated costs.

RAI's operating subsidiaries also purchase unprocessed leaf at market prices, and import cigarettes at prices not to exceed manufacturing costs plus 10%, from BAT affiliates.

On June 12, 2015, RAI and BAT completed the BAT Share Purchase in connection with the Merger and Divestiture. For additional information, see note 2.

On December 1, 2015, RJR Tobacco and Nicoventures Holdings Limited, a subsidiary of BAT, signed a definitive vapor technology-sharing and licensing agreement, pursuant to which the companies will collaborate on the development of next generation vapor products.

Note 19 — RAI Guaranteed, Unsecured Notes — Condensed Consolidating Financial Statements

The following condensed consolidating financial statements relate to the guaranties of RAI's $16.7 billion aggregate principal amount of unsecured notes. See note 12 for additional information relating to these notes. Certain of RAI's direct, wholly owned subsidiaries and certain of its indirectly owned subsidiaries have fully and

unconditionally, and jointly and severally, guaranteed these notes. The following condensed consolidating financial statements include: the accounts and activities of RAI, the parent issuer; RJR, RJR Tobacco, American Snuff Co., SFNTC and certain of RAI's other subsidiaries, the Guarantors; other direct and indirect subsidiaries of RAI that are not Guarantors; and elimination adjustments.

Condensed Consolidating Statements of Income
(Dollars in Millions)

	Parent Issuer	Guarantors	Non-Guarantors	Eliminations	Consolidated
For the Year Ended December 31, 2015					
Net sales	$ —	$10,319	$ 333	$ (236)	$10,416
Net sales, related party	—	259	—	—	259
Net Sales	—	10,578	333	(236)	10,675
Cost of products sold	—	4,673	248	(233)	4,688
Selling, general and administrative expenses	79	1,738	281	—	2,098
Gain on Divestiture	—	(3,153)	(28)	—	(3,181)
Amortization expense	—	18	—	—	18
Asset impairment and exit charges	—	99	—	—	99
Operating income (loss)	(79)	7,203	(168)	(3)	6,953
Interest and debt expense	559	104	7	(100)	570
Interest income	(100)	(6)	—	100	(6)
Other (income) expense, net	20	(42)	(16)	43	5
Income (loss) before income taxes	(558)	7,147	(159)	(46)	6,384
Provision for (benefit from) income taxes	(224)	3,417	(62)	—	3,131
Equity income from subsidiaries	3,587	46	—	(3,633)	—
Net income (loss)	$3,253	$ 3,776	$ (97)	$(3,679)	$ 3,253
For the Year Ended December 31, 2014					
Net sales	$ —	$ 8,109	$ 232	$ (181)	$ 8,160
Net sales, related party	—	311	—	—	311
Net Sales	—	8,420	232	(181)	8,471
Cost of products sold	—	4,002	235	(179)	4,058
Selling, general and administrative expenses	75	1,535	261	—	1,871
Amortization expense	—	11	—	—	11
Operating income (loss)	(75)	2,872	(264)	(2)	2,531
Interest and debt expense	286	79	6	(85)	286
Interest income	(85)	(3)	—	85	(3)
Other (income) expense, net	4	(44)	(17)	43	(14)
Income (loss) from continuing operations before income Taxes	(280)	2,840	(253)	(45)	2,262
Provision for (benefit from) income taxes	(89)	1,004	(98)	—	817
Equity income from subsidiaries	1,661	26	—	(1,687)	—
Income (loss) from continuing operations	1,470	1,862	(155)	(1,732)	1,445
Income from discontinued operations, net of tax	—	25	—	—	25
Net income (loss)	$1,470	$ 1,887	$(155)	$(1,732)	$ 1,470
For the Year Ended December 31, 2013					
Net sales	$ —	$ 7,785	$ 147	$ (33)	$ 7,899
Net sales, related party	—	337	—	—	337
Net Sales	—	8,122	147	(33)	8,236
Cost of products sold	—	3,628	83	(33)	3,678
Selling, general and administrative expenses	13	1,222	154	—	1,389
Amortization expense	—	5	—	—	5
Trademark and other intangible asset impairment charges	—	32	—	—	32
Operating income (loss)	(13)	3,235	(90)	—	3,132
Interest and debt expense	255	113	2	(111)	259
Interest income	(111)	(3)	(2)	111	(5)
Other (income) expense, net	129	(45)	10	43	137
Income (loss) before income taxes	(286)	3,170	(100)	(43)	2,741
Provision for (benefit from) income taxes	(95)	1,154	(36)	—	1,023
Equity income from subsidiaries	1,909	5	—	(1,914)	—
Net income (loss)	$1,718	$ 2,021	$ (64)	$(1,957)	$ 1,718

Condensed Consolidating Statements of Comprehensive Income
(Dollars in Millions)

	Parent Issuer	Guarantors	Non-Guarantors	Eliminations	Consolidated
For the Year Ended December 31, 2015					
Net income (loss)	$3,253	$3,776	$ (97)	$(3,679)	$3,253
Other comprehensive income (loss), net of tax:					
Retirement benefits	50	50	13	(63)	50
Amortization of realized loss on hedging instruments	1	—	—	—	1
Cumulative translation adjustment and other	(25)	(27)	(37)	64	(25)
Comprehensive income (loss)	$3,279	$3,799	$(121)	$(3,678)	$3,279
For the Year Ended December 31, 2014					
Net income (loss)	$1,470	$1,887	$(155)	$(1,732)	$1,470
Other comprehensive income (loss), net of tax:					
Retirement benefits	(277)	(271)	(1)	272	(277)
Unrealized gain on long-term investments	2	2	—	(2)	2
Amortization of realized loss on hedging instruments	1	—	—	—	1
Cumulative translation adjustment and other	(34)	(34)	(48)	82	(34)
Comprehensive income (loss)	$1,162	$1,584	$(204)	$(1,380)	$1,162
For the Year Ended December 31, 2013					
Net income (loss)	$1,718	$2,021	$ (64)	$(1,957)	$1,718
Other comprehensive income (loss), net of tax:					
Retirement benefits	248	239	(1)	(238)	248
Unrealized gain on long-term investments	5	5	—	(5)	5
Amortization of realized loss on hedging instruments	1	—	—	—	1
Cumulative translation adjustment and other	1	1	14	(15)	1
Comprehensive income (loss)	$1,973	$2,266	$ (51)	$(2,215)	$1,973

Details about the reclassifications out of accumulated other comprehensive loss and the affected line items in the consolidating statement of income for the year ended December 31, 2015, were as follows:

Components	Amount Reclassified					Affected Line Item
	Parent Issuer	Guarantors	Non-Guarantors	Eliminations	Consolidated	
Defined benefit pension and postretirement plans:						
Amortization of prior service costs	$ —	(20)	$—	$ —	$ (20)	Cost of products sold
Amortization of prior service costs	—	(19)	—	—	(19)	Selling, general and administrative expenses
MTM adjustment	—	120	—	—	120	Cost of products sold
MTM adjustment	5	121	—	—	126	Selling, general and administrative expenses
	5	202	—	—	207	Operating income (loss)
Deferred taxes	(1)	(78)	—	—	(79)	Provision for income taxes
Defined benefit pension and postretirement plans	124	—	—	(124)	—	Equity income from subsidiaries
Net of tax	$128	$124	—	$(124)	$128	Net income (loss)
Loss on hedging instruments:						
Amortization of realized loss	$ 2	$ —	$—	$ —	$ 2	Interest and debt expense
Deferred taxes	(1)	—	—	—	(1)	Provision for income taxes
Net of tax	$ 1	$ —	$—	$ —	$ 1	Net income (loss)
Total reclassifications	$129	$124	$—	$(124)	$129	Net income (loss)

Details about the reclassifications out of accumulated other comprehensive loss and the affected line items in the consolidating statement of income for the year ended December 31, 2014, were as follows:

Components	Amount Reclassified					Affected Line Item
	Parent Issuer	Guarantors	Non-Guarantors	Eliminations	Consolidated	
Defined benefit pension and postretirement plans:						
Amortization of prior service costs	$ —	(21)	$—	$ —	(21)	Cost of products sold
Amortization of prior service costs	—	(18)	—	—	(18)	Selling, general and administrative expenses
MTM adjustment	—	205	—	—	205	Cost of products sold
MTM adjustment	10	236	1	—	247	Selling, general and administrative expenses
	10	402	1	—	413	Operating income (loss)
Deferred taxes	(4)	(158)	—	—	(162)	Provision for income taxes
Defined benefit pension and postretirement plans	245	—	—	(245)	—	Equity income from subsidiaries
Net of tax	$251	$ 244	$ 1	$(245)	$ 251	Net income (loss)
Loss on hedging instruments:						
Amortization of realized loss	$ 2	$ —	$—	$ —	$ 2	Interest and debt expense
Deferred taxes	(1)	—	—	—	(1)	Provision for income taxes
Net of tax	$ 1	$ —	$—	$ —	$ 1	Net income (loss)
Total reclassifications	$252	$ 244	$ 1	$(245)	$ 252	Net income (loss)

Details about the reclassifications out of accumulated other comprehensive loss and the affected line items in the consolidating statement of income for the year ended December 31, 2013, were as follows:

Components	Amount Reclassified					Affected Line Item
	Parent Issuer	Guarantors	Non-Guarantors	Eliminations	Consolidated	
Defined benefit pension and postretirement plans:						
Amortization of prior service costs	$ —	(21)	$—	$—	(21)	Cost of products sold
Amortization of prior service costs	—	(18)	—	—	(18)	Selling, general and administrative expenses
	—	(39)	—	—	(39)	Operating income (loss)
Deferred taxes	—	16	—	—	16	Provision for income taxes
Defined benefit pension and postretirement plans	(23)	—	—	23	—	Equity income from subsidiaries
Net of tax	$(23)	$(23)	$—	$23	$(23)	Net income (loss)
Loss on hedging instruments:						
Amortization of realized loss	$ 2	$ —	$—	$—	$ 2	Interest and debt expense
Deferred taxes	(1)	—	—	—	(1)	Provision for income taxes
Net of tax	$ 1	$ —	$—	$—	$ 1	Net income (loss)
Total reclassifications	$(22)	$(23)	$—	$23	$(22)	Net income (loss)

Condensed Consolidating Statements of Cash Flows
(Dollars in Millions)

	Parent Issuer	Guarantors	Non-Guarantors	Eliminations	Consolidated
For the Year Ended December 31, 2015					
Cash flows from (used in) operating activities	$ (2,279)	$ 3,219	$ 6	$(750)	$ 196
Cash flows from (used in) investing activities:					
Capital expenditures	—	(160)	(12)	(2)	(174)
Proceeds from settlement of short-term investments	—	265	—	—	265
Proceeds from settlement of long-term investments	—	67	—	—	67
Return of intercompany investments	185	—	—	(185)	—
Acquisition, net of cash acquired	(18,278)	1,001	57	—	(17,220)
Proceeds from Divestiture	7,056	—	—	—	7,056
Other, net	10	22	—	(31)	1
Net cash flows from (used in) investing activities	(11,027)	1,195	45	(218)	(10,005)
Cash flows from (used in) financing activities:					
Dividends paid on common stock	(1,583)	(709)	—	709	(1,583)
Repurchase of common stock	(124)	—	—	—	(124)
Proceeds from BAT Share Purchase	4,673	—	—	—	4,673
Issuance of long-term debt	8,975	—	—	—	8,975
Repayment of long-term debt	(450)	—	—	—	(450)
Debt issuance costs and financing fees	(70)	—	—	—	(70)
Principal borrowings under revolving credit facility	1,400	—	—	—	1,400
Repayments under revolving credit facility	(1,400)	—	—	—	(1,400)
Excess tax benefit on stock-based compensation plans	17	—	—	—	17
Dividends paid on preferred stock	(43)	—	—	43	—
Distribution of equity	—	(185)	—	185	—
Other, net	2,384	(2,445)	30	31	—
Net cash flows from (used in) financing activities	13,779	(3,339)	30	968	11,438
Effect of exchange rate changes on cash and cash equivalents	—	—	(28)	—	(28)
Net change in cash and cash equivalents	473	1,075	53	—	1,601
Cash and cash equivalents at beginning of year	102	469	395	—	966
Cash and cash equivalents at end of year	$ 575	$ 1,544	$448	$ —	$ 2,567

	Parent Issuer	Guarantors	Non-Guarantors	Eliminations	Consolidated
For the Year Ended December 31, 2014					
Cash flows from (used in) operating activities	$ 1,277	$ 1,865	$(179)	$(1,340)	$ 1,623
Cash flows from (used in) investing activities:					
Capital expenditures	—	(265)	(94)	155	(204)
Proceeds from termination of joint venture	—	—	35	—	35
Proceeds from settlement of long-term investments	—	4	—	—	4
Return of intercompany investments	165	—	—	(165)	—
Other, net	218	35	126	(419)	(40)
Net cash flows from (used in) investing activities	383	(226)	67	(429)	(205)
Cash flows from (used in) financing activities:					
Dividends paid on common stock	(1,411)	(1,301)	—	1,301	(1,411)
Repurchase of common stock	(440)	—	—	—	(440)
Excess tax benefit on stock-based compensation plans	12	—	—	—	12
Principal borrowings under revolving credit facility	1,000	—	—	—	1,000
Repayments under revolving credit facility	(1,000)	—	—	—	(1,000)
Debt issuance costs and financing fees	(79)	—	—	—	(79)
Dividends paid on preferred stock	(43)	—	—	43	—
Distribution of equity	—	(165)	—	165	—
Other, net	(41)	(400)	181	260	—
Net cash flows from (used in) financing activities	(2,002)	(1,866)	181	1,769	(1,918)
Effect of exchange rate changes on cash and cash equivalents	—	—	(34)	—	(34)
Net change in cash and cash equivalents	(342)	(227)	35	—	(534)
Cash and cash equivalents at beginning of year	444	696	360	—	1,500
Cash and cash equivalents at end of year	$ 102	$ 469	$ 395	$ —	$ 966

	Parent Issuer	Guarantors	Non-Guarantors	Eliminations	Consolidated
For the Year Ended December 31, 2013					
Cash flows from (used in) operating activities	$ 1,519	$ 945	$ (70)	$(1,086)	$ 1,308
Cash flows from (used in) investing activities:					
Capital expenditures	—	(80)	(74)	1	(153)
Proceeds from termination of joint venture	—	—	31	—	31
Proceeds from settlement of long-term investment	—	6	—	—	6
Return of intercompany investments	300	—	—	(300)	—
Other, net	81	27	(1)	(104)	3
Net cash flows from (used in) investing activities	381	(47)	(44)	(403)	(113)
Cash flows from (used in) financing activities:					
Dividends paid on common stock	(1,335)	(1,042)	—	1,042	(1,335)
Repurchase of common stock	(775)	—	—	—	(775)
Excess tax benefit on stock-based compensation plans	14	—	—	—	14
Principal borrowings under term-loan credit facility	500	—	—	—	500
Repayment under term-loan credit facility	(500)	—	—	—	(500)
Proceeds from issuance of long-term debt, net of discounts	1,097	—	—	—	1,097
Repayments of long-term debt	(975)	(60)	—	—	(1,035)
Debt issuance costs and financing fees	(18)	—	—	—	(18)
Make-whole premium for early extinguishment of debt	(155)	—	—	—	(155)
Dividends paid on preferred stock	(43)	—	—	43	—
Distribution of equity	—	(300)	—	300	—
Other, net	(21)	(220)	137	104	—
Net cash flows from (used in) financing activities	(2,211)	(1,622)	137	1,489	(2,207)
Effect of exchange rate changes on cash and cash equivalents	—	—	10	—	10
Net change in cash and cash equivalents	(311)	(724)	33	—	(1,002)
Cash and cash equivalents at beginning of year	755	1,420	327	—	2,502
Cash and cash equivalents at end of year	$ 444	$ 696	$360	$ —	$ 1,500

Condensed Consolidating Balance Sheets
(Dollars in Millions)

	Parent Issuer	Guarantors	Non-Guarantors	Eliminations	Consolidated
December 31, 2015					
Assets					
Cash and cash equivalents	$ 575	$ 1,544	$448	$ —	$ 2,567
Short term investments	—	149	—	—	149
Accounts receivable	—	62	6	—	68
Accounts receivable, related party	—	38	—	—	38
Other receivables	70	3,459	91	(3,585)	35
Inventories	—	1,694	44	(4)	1,734
Deferred income taxes, net	14	1,011	7	—	1,032
Other current assets	116	323	129	(4)	564
Total current assets	775	8,280	725	(3,593)	6,187
Property, plant and equipment, net	3	1,223	29	—	1,255
Trademarks and other intangible assets, net	—	29,467	—	—	29,467
Goodwill	—	15,976	17	—	15,993
Long-term intercompany notes receivable	1,583	169	—	(1,752)	—
Investment in subsidiaries	37,151	662	—	(37,813)	—
Other assets and deferred charges	267	212	31	(188)	322
Total assets	$39,779	$55,989	$802	$(43,346)	$53,224
Liabilities and shareholders' equity					
Accounts payable	$ 2	$ 173	$ 4	$ —	$ 179
Tobacco settlement accruals	—	2,816	—	—	2,816
Due to related party	—	9	—	—	9
Deferred revenue, related party	—	33	—	—	33
Current maturities of long-term debt	420	86	—	—	506
Dividends on common stock	514	—	—	—	514
Other current liabilities	3,707	1,039	79	(3,591)	1,234
Total current liabilities	4,643	4,156	83	(3,591)	5,291
Long-term intercompany notes payable	169	1,260	323	(1,752)	—
Long-term debt (less current maturities)	16,614	327	—	—	16,941
Deferred income taxes, net	—	10,421	—	(185)	10,236
Long-term retirement benefits (less current portion)	57	2,153	55	—	2,265
Other noncurrent liabilities	44	195	—	—	239
Shareholders' equity	18,252	37,477	341	(37,818)	18,252
Total liabilities and shareholders' equity	$39,779	$55,989	$802	$(43,346)	$53,224

	Parent Issuer	Guarantors	Non-Guarantors	Eliminations	Consolidated
December 31, 2014					
Assets					
Cash and cash equivalents	$ 102	$ 469	$395	$ —	$ 966
Accounts receivable	—	74	42	—	116
Accounts receivable, related party	—	41	—	—	41
Other receivables	70	1,199	10	(1,267)	12
Inventories	—	1,198	85	(2)	1,281
Deferred income taxes, net	5	688	10	—	703
Other current assets	50	151	1	2	204
Total current assets	227	3,820	543	(1,267)	3,323
Property, plant and equipment, net	3	1,170	30	—	1,203
Trademarks and other intangible assets, net	—	2,417	4	—	2,421
Goodwill	—	7,999	17	—	8,016
Long-term intercompany notes receivable	1,593	190	—	(1,783)	—
Investment in subsidiaries	9,598	450	—	(10,048)	—
Other assets and deferred charges	101	180	23	(71)	233
Total assets	$11,522	$16,226	$617	$(13,169)	$15,196
Liabilities and shareholders' equity					
Accounts payable	$ 1	$ 128	$ 13	$ —	$ 142
Tobacco settlement accruals	—	1,819	—	—	1,819
Due to related party	—	1	—	—	1
Deferred revenue, related party	—	32	—	—	32
Current maturities of long-term debt	450	—	—	—	450
Dividends on common stock	356	—	—	—	356
Other current liabilities	1,280	682	51	(1,269)	744
Total current liabilities	2,087	2,662	64	(1,269)	3,544
Long-term intercompany notes payable	190	1,300	293	(1,783)	—
Long-term debt (less current maturities)	4,633	—	—	—	4,633
Deferred income taxes, net	—	450	—	(67)	383
Long-term retirement benefits (less current portion)	57	1,930	10	—	1,997
Other noncurrent liabilities	33	83	1	—	117
Shareholders' equity	4,522	9,801	249	(10,050)	4,522
Total liabilities and shareholders' equity	$11,522	$16,226	$617	$(13,169)	$15,196

Note 20 — RJR Tobacco Guaranteed, Unsecured Notes — Condensed Consolidating Financial Statements

The following condensed consolidating financial statements relate to the guaranties of RJR Tobacco's $377 million aggregate principal amount of unsecured notes, representing the Lorillard Tobacco Notes assumed by RJR Tobacco in connection with the Lorillard Tobacco Merger. RAI and RJR have fully and unconditionally, and jointly and severally, guaranteed these notes. The following condensed consolidating financial statements include: the accounts and activities of RAI, the Parent Guarantor; RJR Tobacco, the Issuer; RJR, a Guarantor; other direct and indirect subsidiaries of RAI that are not Guarantors; and elimination adjustments.

Condensed Consolidating Statements of Income
(Dollars in Millions)

	Parent Guarantor	Issuer	Guarantor	Non-Guarantors	Eliminations	Consolidated
For the Year Ended December 31, 2015						
Net sales	$ —	$8,714	$ —	$ 2,039	$ (337)	$10,416
Net sales, related party	—	259	—	—	—	259
Net sales	—	8,973	—	2,039	(337)	10,675
Cost of products sold	—	4,277	—	746	(335)	4,688
Selling, general and administrative expenses, net	79	2,318	3	(302)	—	2,098
(Gain) loss on Divestiture	—	1,887	—	(5,068)	—	(3,181)
Amortization expense	—	12	—	6	—	18
Asset impairment and exit charges	—	99	—	—	—	99
Operating income (loss)	(79)	380	(3)	6,657	(2)	6,953
Interest and debt expense	559	20	—	94	(103)	570
Interest income	(100)	(5)	(4)	—	103	(6)
Other (income) expense, net	20	2	(43)	(17)	43	5
Income (loss) from continuing operations before income taxes	(558)	363	44	6,580	(45)	6,384
Provision for (benefit from) income taxes	(224)	928	—	2,427	—	3,131
Equity income (loss) from subsidiaries	3,587	3,732	3,185	—	(10,504)	—
Net income (loss)	$3,253	$3,167	$3,229	$ 4,153	$(10,549)	$ 3,253
For the Year Ended December 31, 2014						
Net sales	$ —	$6,728	$ —	$ 1,701	$ (269)	$ 8,160
Net sales, related party	—	311	—	—	—	311
Net sales	—	7,039	—	1,701	(269)	8,471
Cost of products sold	—	3,641	—	686	(269)	4,058
Selling, general and administrative expenses, net	75	1,629	6	161	—	1,871
Amortization expense	—	4	—	7	—	11
Operating income (loss)	(75)	1,765	(6)	847	—	2,531
Interest and debt expense	286	21	—	67	(88)	286
Interest income	(85)	(2)	(3)	(1)	88	(3)
Other (income) expense, net	4	1	(45)	(17)	43	(14)
Income (loss) from continuing operations before income taxes	(280)	1,745	42	798	(43)	2,262
Provision for (benefit from) income taxes	(89)	627	(1)	280	—	817
Equity income (loss) from subsidiaries	1,661	279	1,425	—	(3,365)	—
Net income (loss) from continuing operations	1,470	1,397	1,468	518	(3,408)	1,445
Income from discontinued operations, net of tax	—	25	—	—	—	25
Net income (loss)	$1,470	$1,422	$1,468	$ 518	$ (3,408)	$ 1,470

	Parent Guarantor	Issuer	Guarantor	Non-Guarantors	Eliminations	Consolidated
For the Year Ended December 31, 2013						
Net sales	$ —	$6,505	$ —	$ 1,493	$ (99)	$ 7,899
Net sales, related party	—	337	—	—	—	337
Net sales	—	6,842	—	1,493	(99)	8,236
Cost of products sold	—	3,280	—	497	(99)	3,678
Selling, general and administrative expenses, net	13	1,348	—	28	—	1,389
Amortization expense	—	4	—	1	—	5
Trademark and other intangible asset impairment charges	—	—	—	32	—	32
Operating income (loss)	(13)	2,210	—	935	—	3,132
Interest and debt expense	255	23	3	92	(114)	259
Interest income	(111)	(3)	(3)	(2)	114	(5)
Other (income) expense, net	129	1	(46)	10	43	137
Income (loss) from continuing operations before income taxes	(286)	2,189	46	835	(43)	2,741
Provision for (benefit from) income taxes	(95)	841	(2)	279	—	1,023
Equity income (loss) from subsidiaries	1,909	259	1,605	—	(3,773)	—
Net income (loss)	$1,718	$1,607	$1,653	$ 556	$ (3,816)	$ 1,718

Condensed Consolidating Statements of Comprehensive Income
(Dollars in Millions)

	Parent Guarantor	Issuer	Guarantor	Non-Guarantors	Eliminations	Consolidated
For the Year Ended December 31, 2015						
Net income (loss)	$3,253	$3,167	$3,229	$4,153	$(10,549)	$3,253
Other comprehensive income (loss), net of tax:						
Retirement benefits	50	39	51	12	(102)	50
Amortization of realized loss on hedging instruments	1	—	—	—	—	1
Cumulative translation adjustment and other	(25)	(25)	(25)	(26)	76	(25)
Comprehensive income (loss)	$3,279	$3,181	$3,255	$4,139	$(10,575)	$3,279
For the Year Ended December 31, 2014						
Net income (loss)	$1,470	$1,422	$1,468	$ 518	$ (3,408)	$1,470
Other comprehensive income (loss), net of tax:						
Retirement benefits	(277)	(259)	(261)	(11)	531	(277)
Unrealized gain (loss) on long-term investments	2	2	2	—	(4)	2
Amortization of realized loss on hedging instruments	1	—	—	—	—	1
Cumulative translation adjustment and other	(34)	(32)	(32)	(33)	97	(34)
Comprehensive income (loss)	$1,162	$1,133	$1,177	$ 474	$ (2,784)	$1,162
For the Year Ended December 31, 2013						
Net income (loss)	$1,718	$1,607	$1,653	$ 556	$ (3,816)	$1,718
Other comprehensive income (loss), net of tax:						
Retirement benefits	248	226	227	11	(464)	248
Unrealized gain (loss) on long-term investments	5	5	5	—	(10)	5
Amortization of realized loss on hedging instruments	1	—	—	—	—	1
Cumulative translation adjustment and other	1	3	2	2	(7)	1
Comprehensive income (loss)	$1,973	$1,841	$1,887	$ 569	$ (4,297)	$1,973

Details about the reclassifications out of accumulated other comprehensive loss and the affected line items in the condensed consolidating statement of income for the year ended December 31, 2015, were as follows:

Components	Amounts Reclassified						Affected Line Item
	Parent Guarantor	Issuer	Guarantor	Non-Guarantors	Eliminations	Consolidated	
Defined benefit pension and postretirement plans:							
Amortization of prior service costs	$ —	$ (19)	$ —	$ (1)	$ —	$ (20)	Cost of products sold
Amortization of prior service costs	—	(17)	(1)	(1)		(19)	Selling, general and administrative expenses, net
MTM Adjustment	—	119	—	1	—	120	Cost of products sold
MTM Adjustment	5	110	3	8	—	126	Selling, general and administrative expenses, net
	5	193	2	7	—	207	Operating income (loss)
Deferred taxes	(1)	(74)	(1)	(3)	—	(79)	Provision for income taxes
Defined benefit pension and postretirement plans	124	—	118	—	(242)	—	Equity income (loss) from subsidiaries
Net of tax	128	119	119	4	(242)	128	Net income (loss)
Loss on hedging instruments:							
Amortization of realized loss	2	—	—	—	—	2	Interest and debt expense
Deferred taxes	(1)	—	—	—	—	(1)	Provision for income taxes
Net of tax	1	—	—	—	—	1	Net income (loss)
Total reclassifications	$129	$119	$119	$ 4	$(242)	$129	Net income (loss)

Details about the reclassifications out of accumulated other comprehensive loss and the affected line items in the condensed consolidating statement of income for the year ended December 31, 2014, were as follows:

Components	Amounts Reclassified						Affected Line Item
	Parent Guarantor	Issuer	Guarantor	Non-Guarantors	Eliminations	Consolidated	
Defined benefit pension and postretirement plans:							
Amortization of prior service costs	$ —	$ (20)	$ —	$ (1)	$ —	$ (21)	Cost of products sold
Amortization of prior service costs	—	(17)	—	(1)	—	(18)	Selling, general and administrative expenses, net
MTM Adjustment	—	195	—	10	—	205	Cost of products sold
MTM Adjustment	10	228	4	5	—	247	Selling, general and administrative expenses, net
	10	386	4	13	—	413	Operating income (loss)
Deferred taxes	(4)	(152)	(1)	(5)	—	(162)	Provision for income taxes
Defined benefit pension and postretirement plans	245	—	234	—	(479)	—	Equity income (loss) from subsidiaries
Net of tax	251	234	237	8	(479)	251	Net income (loss)
Loss on hedging instruments:							
Amortization of realized loss	2	—	—	—	—	2	Interest and debt expense
Deferred taxes	(1)	—	—	—	—	(1)	Provision for income taxes
Net of tax	1	—	—	—	—	1	Net income (loss)
Total reclassifications	$252	$ 234	$237	$ 8	$(479)	$ 252	Net income (loss)

Details about the reclassifications out of accumulated other comprehensive loss and the affected line items in the condensed consolidating statement of income for the year ended December 31, 2013, were as follows:

Components	Amounts Reclassified						Affected Line Item
	Parent Guarantor	Issuer	Guarantor	Non-Guarantors	Eliminations	Consolidated	
Defined benefit pension and postretirement plans:							
Amortization of prior service costs	$ —	$(20)	$ —	$ (1)	$—	$(21)	Cost of products sold
Amortization of prior service costs	—	(17)	—	(1)	—	(18)	Selling, general and administrative expenses, net
	—	(37)	—	(2)	—	(39)	Operating income (loss)
Deferred taxes	—	15	—	1	—	16	Provision for income taxes
Defined benefit pension and postretirement plans	(23)	—	(22)	—	45	—	Equity income (loss) from subsidiaries
Net of tax	(23)	(22)	(22)	(1)	45	(23)	Net income (loss)
Loss on hedging instruments:							
Amortization of realized loss	2	—	—	—	—	2	Interest and debt expense
Deferred taxes	(1)	—	—	—	—	(1)	Provision for income taxes
Net of tax	1	—	—	—	—	1	Net income (loss)
Total reclassifications	$(22)	$(22)	(22)	$ (1)	$45	$(22)	Net income (loss)

Condensed Consolidating Statements of Cash Flows
(Dollars in Millions)

	Parent Guarantor	Issuer	Guarantor	Non-Guarantors	Eliminations	Consolidated
For the Year Ended December 31, 2015						
Cash flows from (used in) operating activities	$ (2,279)	$ 2,924	$ 549	$ 422	$(1,420)	$ 196
Cash flows from (used in) investing activities:						
Capital expenditures	—	(99)	—	(73)	(2)	(174)
Proceeds from settlement of short-term investments	—	265	—	—	—	265
Proceeds from settlement of long-term investments	—	67	—	—	—	67
Return of intercompany investments	185	11	344	—	(540)	—
Acquisition, net of cash acquired	(18,278)	523	—	535	—	(17,220)
Proceeds from Divestiture	7,056	—	—	—	—	7,056
Other, net	10	1	17	21	(48)	1
Net cash flows from (used in) from investing activities	(11,027)	768	361	483	(590)	(10,005)
Cash flows from (used in) financing activities:						
Dividends paid on common stock	(1,583)	(461)	(709)	(209)	1,379	(1,583)
Repurchase of common stock	(124)	—	—	—	—	(124)
Proceeds from BAT Share Purchase	4,673	—	—	—	—	4,673
Issuance of long-term debt, net of discounts	8,975	—	—	—	—	8,975
Repayment of long-term debt	(450)	—	—	—	—	(450)
Debt issuance costs and financing fees	(70)	—	—	—	—	(70)
Principal borrowings under revolving credit facility	1,400	—	—	—	—	1,400
Repayments under revolving credit facility	(1,400)	—	—	—	—	(1,400)
Excess tax benefit on stock-based compensation plans	17	—	—	—	—	17
Dividends paid on preferred stock	(43)	—	—	—	43	—
Distribution of equity	—	(344)	(185)	(11)	540	—
Other, net	2,384	(2,405)	—	(27)	48	—
Net cash flows from (used in) financing activities	13,779	(3,210)	(894)	(247)	2,010	11,438
Effect of exchange rate changes on cash and cash equivalents	—	—	—	(28)	—	(28)
Net change in cash and cash equivalents	473	482	16	630	—	1,601
Cash and cash equivalents at beginning of period	102	327	3	534	—	966
Cash and cash equivalents at end of period	$ 575	$ 809	$ 19	$1,164	$ —	$ 2,567

Condensed Consolidating Statements of Cash Flows
(Dollars in Millions)

	Parent Guarantor	Issuer	Guarantor	Non-Guarantors	Eliminations	Consolidated
For the Year Ended December 31, 2014						
Cash flows from (used in) operating activities	$ 1,277	$ 1,364	$ 1,424	$ 524	$(2,966)	$ 1,623
Cash flows from (used in) investing activities:						
Capital expenditures	—	(232)	—	(127)	155	(204)
Proceeds from termination of joint venture	—	—	—	35	—	35
Proceeds from settlement of long-term investment	—	2	2	—	—	4
Return of intercompany investments	165	105	21	—	(291)	—
Other, net	218	(8)	19	187	(456)	(40)
Net cash flows from (used in) investing activities	383	(133)	42	95	(592)	(205)
Cash flows from (used in) financing activities:						
Dividends paid on common stock	(1,411)	(1,377)	(1,301)	(250)	2,928	(1,411)
Repurchase of common stock	(440)	—	—	—	—	(440)
Excess tax benefit on stock-based compensation	12	—	—	—	—	12
Principal borrowings under revolving credit facility	1,000	—	—	—	—	1,000
Repayments under revolving credit facility	(1,000)	—	—	—	—	(1,000)
Debt issuance costs and financing fees	(79)	—	—	—	—	(79)
Dividends paid on preferred stock	(43)	—	—	—	43	—
Distribution of equity	—	(21)	(165)	(105)	291	—
Other, net	(41)	(20)	—	(235)	296	—
Net cash flows from (used in) financing activities	(2,002)	(1,418)	(1,466)	(590)	3,558	(1,918)
Effect of exchange rate changes on cash and cash equivalents	—	—	—	(34)	—	(34)
Net change in cash and cash equivalents	(342)	(187)	—	(5)	—	(534)
Cash and cash equivalents at beginning of period	444	514	3	539	—	1,500
Cash and cash equivalents at end of period	$ 102	$ 327	$ 3	$ 534	$ —	$ 966

	Parent Guarantor	Issuer	Guarantor	Non-Guarantors	Eliminations	Consolidated
For the Year Ended December 31, 2013						
Cash flows from (used in) operating activities	$ 1,519	$ 945	$ 1,108	$ 424	$(2,688)	$ 1,308
Cash flows from (used in) investing activities:						
Capital expenditures	—	(55)	—	(99)	1	(153)
Proceeds from termination of joint venture	—	—	—	31	—	31
Proceeds from settlement of long-term investment	—	2	4	—	—	6
Contributions to intercompany investments	—	—	—	—	—	—
Return of intercompany investments	300	15	365	—	(680)	—
Other, net	81	1	17	271	(367)	3
Net cash flows from (used in) investing activities	381	(37)	386	203	(1,046)	(113)
Cash flows from (used in) financing activities:						
Dividends paid on common stock	(1,335)	(1,065)	(1,042)	(537)	2,644	(1,335)
Repurchase of common stock	(775)	—	—	—	—	(775)
Debt issuance costs and financing fees	(18)	—	—	—	—	(18)
Principal borrowings under revolving credit facility	500	—	—	—	—	500
Repayments under revolving credit facility	(500)	—	—	—	—	(500)
Proceeds from issuance of long-term debt, net of discounts	1,097	—	—	—	—	1,097
Repayment of long-term debt	(975)	—	(60)	—	—	(1,035)
Make-whole premium for early extinguishment of debt	(155)	—	—	—	—	(155)
Excess tax benefit on stock-based compensation	14	—	—	—	—	14
Dividends paid on preferred stock	(43)	—	—	—	43	—
Distribution of equity	—	(365)	(300)	(15)	680	—
Other, net	(21)	(153)	(95)	(98)	367	—
Net cash flows from (used in) financing activities	(2,211)	(1,583)	(1,497)	(650)	3,734	(2,207)
Effect of exchange rate changes on cash and cash equivalents	—	—	—	10	—	10
Net change in cash and cash equivalents	(311)	(675)	(3)	(13)	—	(1,002)
Cash and cash equivalents at beginning of period	755	1,189	6	552	—	2,502
Cash and cash equivalents at end of period	$ 444	$ 514	$ 3	$ 539	$ —	$ 1,500

Condensed Consolidating Balance Sheets
(Dollars in Millions)

	Parent Guarantor	Issuer	Guarantor	Non-Guarantors	Eliminations	Consolidated
December 31, 2015						
Assets						
Cash and cash equivalents	$ 575	$ 809	$ 19	$ 1,164	$ —	$ 2,567
Short-term investments	—	149	—	—	—	149
Accounts receivable	—	48	—	20	—	68
Accounts receivable, related party	—	38	—	—	—	38
Other receivables	70	30	17	4,890	(4,972)	35
Inventories	—	941	—	797	(4)	1,734
Deferred income taxes, net	14	928	1	89	—	1,032
Other current assets	116	236	—	212	—	564
Total current assets	775	3,179	37	7,172	(4,976)	6,187
Property, plant and equipment, net	3	792	—	460	—	1,255
Trademarks and other intangible assets, net	—	346	—	29,121	—	29,467
Goodwill	—	3,453	9,853	2,687	—	15,993
Long-term intercompany notes receivable	1,583	—	90	169	(1,842)	—
Investment in subsidiaries	37,151	23,199	24,276	—	(84,626)	—
Other assets and deferred charges	267	783	13	9	(750)	322
Total assets	$39,779	$31,752	$34,269	$39,618	$(92,194)	$53,224
Liabilities and shareholders' equity						
Accounts payable	$ 2	$ 146	$ —	$ 31	$ —	$ 179
Tobacco settlement accruals	—	2,673	—	143	—	2,816
Due to related party	—	9	—	—	—	9
Deferred revenue, related party	—	33	—	—	—	33
Current maturities of long-term debt	420	86	—	—	—	506
Dividends payable on common stock	514	—	—	—	—	514
Other current liabilities	3,707	2,189	31	284	(4,977)	1,234
Total current liabilities	4,643	5,136	31	458	(4,977)	5,291
Long-term intercompany notes payable	169	—	—	1,673	(1,842)	—
Long-term debt (less current maturities)	16,614	327	—	—	—	16,941
Deferred income taxes, net	—	1	—	10,981	(746)	10,236
Long-term retirement benefits (less current portion)	57	2,036	30	142	—	2,265
Other noncurrent liabilities	44	182	—	13	—	239
Shareholders' equity	18,252	24,070	34,208	26,351	(84,629)	18,252
Total liabilities and shareholders' equity	$39,779	$31,752	$34,269	$39,618	$(92,194)	$53,224

Condensed Consolidating Balance Sheets
(Dollars in Millions)

	Parent Guarantor	Issuer	Guarantor	Non-Guarantors	Eliminations	Consolidated
December 31, 2014						
Assets						
Cash and cash equivalents	$ 102	$ 327	$ 3	$ 534	$ —	$ 966
Accounts receivable	—	61	—	55	—	116
Accounts receivable, related party	—	41	—	—	—	41
Other receivables	70	291	20	1,864	(2,233)	12
Inventories	—	529	—	754	(2)	1,281
Deferred income taxes, net	5	611	1	86	—	703
Other current assets	50	118	—	34	2	204
Total current assets	227	1,978	24	3,327	(2,233)	3,323
Property, plant and equipment, net	3	765	—	435	—	1,203
Trademarks and other intangible assets, net	—	130	—	2,291	—	2,421
Goodwill	—	5,302	—	2,714	—	8,016
Long-term intercompany notes receivable	1,593	—	106	190	(1,889)	—
Investment in subsidiaries	9,598	3,060	6,941	—	(19,599)	—
Other assets and deferred charges	101	731	18	18	(635)	233
Total assets	$11,522	$11,966	$7,089	$8,975	$(24,356)	$15,196
Liabilities and shareholders' equity						
Accounts payable	$ 1	$ 110	$ —	$ 31	$ —	$ 142
Tobacco settlement accruals	—	1,709	—	110	—	1,819
Due to related party	—	1	—	—	—	1
Deferred revenue, related party	—	32	—	—	—	32
Current maturities of long-term debt	450	—	—	—	—	450
Dividends payable on common stock	356	—	—	—	—	356
Other current liabilities	1,280	1,274	3	423	(2,236)	744
Total current liabilities	2,087	3,126	3	564	(2,236)	3,544
Long-term intercompany notes payable	190	—	—	1,699	(1,889)	—
Long-term debt (less current maturities)	4,633	—	—	—	—	4,633
Deferred income taxes, net	—	1	—	1,013	(631)	383
Long-term retirement benefits (less current portion)	57	1,822	30	88	—	1,997
Other noncurrent liabilities	33	78	—	6	—	117
Shareholders' equity	4,522	6,939	7,056	5,605	(19,600)	4,522
Total liabilities and shareholders' equity	$11,522	$11,966	$7,089	$8,975	$(24,356)	$15,196

Note 21 — Quarterly Results of Operations (Unaudited)

	First	Second	Third	Fourth
2015				
Net sales	$2,057	$2,403	$3,161	$3,054
Gross profit (1)	1,207	1,319	1,757	1,704
Net income (1)(2)	389	1,928	657	279
Per share data (3):				
Basic:				
Net income	0.36	1.70	0.46	0.20
Diluted:				
Net income	0.36	1.69	0.46	0.19
2014				
Net sales	$1,935	$2,162	$2,240	$2,134
Gross profit (4)	1,005	1,203	1,206	999
Income from continuing operations (4)(5)	338	492	467	148
Income from discontinued operations, net of tax	25	—	—	—
Net income (4)(5)	363	492	467	148
Per share data (3):				
Basic:				
Income from continuing operations	0.32	0.46	0.44	0.14
Income from discontinued operations	0.02	—	—	—
Net income	0.34	0.46	0.44	0.14
Diluted:				
Income from continuing operations	0.32	0.46	0.44	0.14
Income from discontinued operations	0.02	—	—	—
Net income	0.34	0.46	0.44	0.14

(1) Includes NPM Adjustment credits of $136 million in the first quarter of 2015, $69 million in the second quarter of 2015, $76 million in the third quarter of 2015 and $109 million in the fourth quarter of 2015, see "— Cost of Products Sold" in note 1. The fourth quarter of 2015 includes an MTM adjustment of $120 million.

(2) Fourth quarter of 2015 includes an additional MTM adjustment of $126 million for a total of $246 million.

(3) Income per share is computed independently for each of the periods presented. The sum of the income per share amounts for the quarters may not equal the total for the year.

(4) Includes NPM Adjustment credits of $63 million in the first quarter of 2014, $125 million in the second quarter of 2014, $82 million in the third quarter of 2014 and $75 million in the fourth quarter of 2014, see "— Cost of Products Sold" in note 1. The fourth quarter of 2014 includes an MTM adjustment of $205 million.

(5) Fourth quarter of 2014 includes an additional MTM adjustment of $247 million for a total of $452 million.

Note 22 — Subsequent Events

Sale of International Rights of NATURAL AMERICAN SPIRIT Brand

On January 13, 2016, RAI, through the Sellers, completed the sale of the international rights to the NATURAL AMERICAN SPIRIT brand name and associated trademarks, along with the international companies that distribute and market the brand outside the United States to JTI Holding, a subsidiary of JTI, in an all-cash transaction with a value of approximately $5 billion.

The 2015 Purchase Agreement contains customary representations, warranties and covenants made by the Sellers and JTI Holding, and, for certain provisions, RAI and JTI, and contains indemnification provisions, subject to customary limitations, with respect to these and other matters, including potential litigation relating to specified claims. The 2015 Purchase Agreement also contains a guarantee of Sellers' obligations by RAI, and a guarantee of JTI Holding's obligations by JTI. Further, in the 2015 Purchase Agreement, RAI has agreed not to, and agreed to cause its controlled affiliates not to, engage in the business of producing, selling, distributing and developing natural, organic and additive-free combustible tobacco cigarettes and roll-your-own or make-your-own tobacco products outside of the United States, and JTI has agreed not to, and agreed to cause its controlled affiliates not to, engage in the conduct of such business in the United States, in each case, for five years following the closing of the transaction.

The transaction does not include the rights to the NATURAL AMERICAN SPIRIT brand name and associated trademarks in the U.S. market, U.S. duty-free locations, and U.S. territories or in U.S. military outlets,

all of which have been retained by SFNTC. With this transaction completed, the international rights to nearly all of RAI's operating companies' cigarette trademarks are now owned by international tobacco companies.

In accordance with accounting guidance, the assets and liabilities of the disposal group were reclassified, respectively, as assets held for sale, which are included in other current assets, and liabilities held for sale, which are included in other current liabilities, in the consolidated balance sheet at December 31, 2015. A gain will be recorded in the first quarter of 2016 in the All Other segment. For further information related to goodwill and other intangible assets reclassified as held for sale, see note 4.

Tender Offer and Redemption (Unaudited)

On February 4, 2016, RAI commenced a cash tender offer for the maximum amount of specified series of its outstanding debt that it can purchase for up to $2.8 billion in cash, excluding accrued and unpaid interest to, but not including, the applicable settlement date and excluding related fees and expenses, referred to as the Tender Cap. Pursuant to the tender offer, RAI is offering to purchase, subject to the Tender Cap and other conditions and limitations, its 4.750% Senior Notes due 2042, 3.250% Senior Notes due 2022, 3.750% Senior Notes due 2023, 3.250% Senior Notes due 2020, 4.000% Senior Notes due 2022, 4.450% Senior Notes due 2025 and 4.850% Senior Notes due 2023. Such notes are collectively referred to as the Securities. At the commencement of the tender offer, the aggregate principal amount of the Securities outstanding was $7,874 million.

Also on February 4, 2016, RAI called for the redemption of all $700 million outstanding aggregate principal amount of its 6.750% Senior Notes due 2017 and all $250 million outstanding aggregate principal amount of its 7.750% Senior Notes due 2018. The expected redemption date is March 5, 2016.

The early tender date for the tender offer is 5:00 p.m., New York City time, on February 18, 2016, unless extended. The expiration date of the tender offer is 11:59 p.m., New York City time, on March 3, 2016, unless extended or earlier terminated. The terms, conditions and limitations of the tender offer are described in an offer to purchase being delivered to the holders of the Securities.

Holders of the Securities must validly tender and not validly withdraw their Securities on or before the early tender date to be eligible to receive the total consideration (as described below). Tendered Securities may only be withdrawn on or before 5:00 p.m., New York City time, on February 18, 2016, unless such withdrawal date is extended. Securities tendered after the withdrawal date may not be withdrawn.

The table below sets forth certain information regarding the Securities and the tender offer.

Title of Security	Principal Amount Outstanding	Acceptance Priority Level	Reference U.S. Treasury Security	Fixed Spread
4.750% Senior Notes due 2042	$1,000	1	2.875% due August 15, 2045	190 bps
3.250% Senior Notes due 2022	1,100	2	1.375% due January 31, 2021	135 bps
3.750% Senior Notes due 2023	474	3	2.250% due November 15, 2025	105 bps
3.250% Senior Notes due 2020	1,250	4	1.375% due January 31, 2021	85 bps
4.000% Senior Notes due 2022	1,000	5	1.375% due January 31, 2021	125 bps
4.450% Senior Notes due 2025	2,500	6	2.250% due November 15, 2025	140 bps
4.850% Senior Notes due 2023	550	7	2.250% due November 15, 2025	110 bps

The total consideration for each $1,000 principal amount of Securities tendered and accepted for payment by RAI pursuant to the tender offer will be determined in the manner described in the offer to purchase by reference to a fixed spread specified in the table above for each series of the Securities over the yield based on the bid-side price of the U.S. Treasury Security specified in the table above, as calculated by the dealer managers for the tender offer at 2:00 p.m., New York City time, on February 19, 2016. Holders of Securities who validly tender their Securities after the early tender date will, if such Securities are accepted by RAI, receive the tender consideration, which is equal to the total consideration minus $30 per $1,000 principal amount of Securities tendered by such holders and accepted for purchase by RAI. Accrued and unpaid interest up to, but excluding, the applicable settlement date will be paid in cash on all validly tendered Securities accepted and purchased by RAI in the tender offer. The consideration for the Securities is expected to be paid by RAI with cash on hand.

RAI reserves the right, but is not obligated, to increase the Tender Cap.

RAI expects to accept for purchase any validly tendered and not validly withdrawn Securities on or before the early tender date, subject to the Tender Cap and except as indicated below, in accordance with, and in the order of, the acceptance priority levels set forth in the table above. The initial settlement date is currently expected to occur on February 22, 2016. RAI expects to purchase any remaining Securities that have been validly

tendered and not validly withdrawn by the expiration of the tender offer and accepted for purchase, subject to the Tender Cap and the application of the acceptance priority levels, and except as indicated below, one business day following the expiration date of the tender offer.

All Securities validly tendered and not validly withdrawn on or before the early tender date having a higher acceptance priority level will be accepted before any tendered Securities having a lower acceptance priority level, and all Securities validly tendered after the early tender date having a higher acceptance priority level will be accepted before any Securities validly tendered after the early tender date having a lower acceptance priority level. However, Securities validly tendered and not validly withdrawn on or before the early tender date will be accepted for purchase in priority to other Securities validly tendered after the early tender date even if such Securities tendered after the early tender date have a higher acceptance priority level than the Securities validly tendered prior to the early tender date.

If purchasing all of the tendered Securities of a series on any settlement date would cause the Tender Cap to be exceeded, the amount of that series of Securities purchased on that settlement date will be prorated based on the aggregate principal consideration payable for that series of Securities tendered in respect of that settlement date such that the Tender Cap will not be exceeded. Furthermore, if the tender offer is fully subscribed as of the early tender date, holders who validly tender Securities after the early tender date will not have their Securities accepted for purchase.

RAI’s obligation to accept for purchase and to pay for Securities validly tendered and not validly withdrawn pursuant to the tender offer is conditioned upon satisfaction of certain conditions, including the condition that RAI have sufficient cash on hand, at each of the early tender date and expiration date, to purchase on the applicable settlement date all Securities validly tendered and not validly withdrawn by such dates, and to pay all related fees and expenses in connection with the tender offer. See note 12.

Independent Auditors' Report

The Board of Directors
B.A.T Capital Corporation:

We have audited the accompanying financial statements of B.A.T Capital Corporation (the Company), which comprise the balance sheets as of December 31, 2016 and 2015, and the related statements of operations, shareholder's equity, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2016 and 2015, and the results of its operations and its cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.

/s/ KPMG LLP
Louisville, Kentucky
April 19, 2017

B.A.T CAPITAL CORPORATION

Balance Sheets
December 31, 2016 and 2015
(Dollars in thousands, except per share amounts)

	2016	2015
Assets		
Current assets:		
Due from affiliates	$10,050	16,172
Other receivables	—	18
Total current assets	10,050	16,190
Total assets	$10,050	16,190
Liabilities and Shareholder's Equity		
Current liabilities:		
Accounts payable and accrued liabilities	$ 4	—
Total current liabilities	4	—
Total liabilities	4	—
Shareholder's equity:		
Common shares, $1 par value (2,000 shares authorized, issued and outstanding)	2	2
Additional paid-in capital	9,999	9,999
Accumulated earnings	45	6,189
Total shareholder's equity	10,046	16,190
Total liabilities and shareholder's equity	$10,050	16,190

See accompanying notes to financial statements.

B.A.T CAPITAL CORPORATION

Statements of Operations
Years ended December 31, 2016 and 2015
(In thousands)

	2016	2015
Interest income	$21	—
Total income	21	—
General and administrative expenses	12	28
Total expenses	12	28
Income (loss) before income taxes	9	(28)
Income tax expense (benefit)	3	(10)
Net income (loss)	$ 6	(18)

See accompanying notes to financial statements.

B.A.T CAPITAL CORPORATION

Statements of Shareholder's Equity
Years ended December 31, 2016 and 2015
(Dollars in thousands)

	Common shares		Additional paid-in-capital	Accumulated earnings	Total
	Shares	Amount			
Balance at December 31, 2014	2,000	$ 2	9,999	6,207	16,208
Net Loss	—	—	—	(18)	(18)
Balance at December 31, 2015	2,000	2	9,999	6,189	16,190
Net Income	—	—	—	6	6
Dividends	—	—	—	(6,150)	(6,150)
Balance at December 31, 2016	2,000	$ 2	9,999	45	10,046

See accompanying notes to financial statements.

B.A.T CAPITAL CORPORATION

Statements of Cash Flows
Years ended December 31, 2016 and 2015
(In thousands)

	2016	2015
Cash flows from operating activities:		
Net income (loss)	$ 6	(18)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Decrease (increase) in other receivables	18	(10)
Increase in accounts payable and accrued liabilities	4	—
Net cash provided by (used in) operating activities	28	(28)
Cash flows from investing activities:		
Net proceeds from investments with affiliates	6,122	28
Net cash provided by investing activities	6,122	28
Cash flows from financing activities:		
Dividends paid	(6,150)	—
Net cash used in financing activities	(6,150)	—
Net increase (decrease) in cash	—	—
Cash — beginning of year	—	—
Cash — end of year	$ —	—
Supplemental cash flow information:		
Income taxes refunded	$ 18	—

See accompanying notes to financial statements.

B.A.T CAPITAL CORPORATION

Notes to Financial Statements
December 31, 2016 and 2015

(1) Summary of Significant Accounting Policies

(a) Basis of Presentation

The accompanying financial statements present the financial position, results of operations and cash flows of B.A.T Capital Corporation (the Company), an indirect wholly owned subsidiary of British American Tobacco p.l.c. (BAT), a company incorporated under the laws of England and Wales. Until December 7, 2016, the Company was a direct subsidiary of BAT. On December 7, 2016, following a sale of the Company by BAT to Louisville Securities Limited (LSL), the Company was purchased by BATUS Holdings Inc. (BHI) from LSL pursuant to a stock purchase agreement and BHI became the sole stockholder and parent of the Company. The sale and purchase were at carrying value. The Company, incorporated in Delaware, has 2,000 common shares authorized, issued and outstanding with a par value of one dollar per share. The accompanying financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America.

(b) Nature of Business

The Company is a U.S. finance company that has historically been a guarantor of the BAT Euro Medium Term Debt Programme (see note 5) and has provided financing and cash management services to BAT companies in the US. Other than its role as a guarantor, the Company has been inactive in recent years.

(c) Income Taxes

The Company accounts for income taxes in accordance with the provision of Accounting Standards Codification (ASC) 740, *Income Taxes* (ASC 740). ASC 740 applies an asset and liability approach that requires the recognition of deferred tax assets and liabilities with respect to the expected future tax consequences of events that have been recognized in the financial statements and tax returns. Income tax expense recorded in 2016 and the income tax benefit recorded in 2015 were computed by applying the U.S. federal income tax rate of 35% to pretax income or loss. There are no temporary or permanent differences in 2016 and 2015. The Company paid no state income taxes in 2016 or 2015.

Uncertain income tax benefits are recognized only if they are “more likely than not” to be sustained based solely on their technical merits as of the reporting date. The more likely than not threshold represents a positive assertion by management that a company is entitled to the economic benefits of a tax position. If a tax position is not considered more likely than not to be sustained based solely on its technical merits, no benefits of the tax position are to be recognized. The more likely than not threshold must continue to be met in each reporting period to support recognition of a benefit.

The Company did not have any uncertain tax positions for 2016 or 2015. The federal statute of limitations remains open for tax years 2013 through 2015. State jurisdictions generally have statutes of limitations ranging from three to five years. The state income tax impact of federal income tax changes remains subject to examination by various states for a period up to one year after formal notification to the states.

(d) Interest Income

Interest income was $21 thousand and $0 for the years ended December 31, 2016 and 2015, respectively. All interest income was from related parties.

(e) Other Comprehensive Income

The Company has no other components of comprehensive income (loss) other than its net income (loss) for all periods presented.

(f) Accounting Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts in the financial statements and accompanying notes. Actual results could differ from those estimates.

(g) Contingencies

In accordance with ASC 450, *Contingencies*, the Company records any loss related to a contingency at the time that likelihood of a loss becomes probable and the amount of the loss can be reasonably estimated. When the reasonable estimate is a range, the best estimate within that range will be recorded. When no amount within the range is more likely, the lowest amount within the range will be recorded. No such amounts were recorded for the years ended December 31, 2016 and 2015.

(2) Income Taxes

The income tax expense (benefit) consists of the following for the years ended December 31, 2016 and 2015 (in thousands):

	Current	Deferred	Total
Year ended December 31, 2016:			
U.S. federal	$ 3	—	3
State and local	—	—	—
	$ 3	—	3
Year ended December 31, 2015:			
U.S. federal	$(10)	—	(10)
State and local	—	—	—
	$(10)	—	(10)

As of December 31, 2016 and 2015, the Company had no deferred tax assets and liabilities.

There was no unrecognized tax benefits, interest expense or penalties recognized related to uncertain tax positions in 2016 or 2015.

(3) Related Party Assets

The Company has an In-House Cash agreement with B.A.T. International Finance p.l.c. (BATIF). Under this agreement, positive balances are swept from and necessary funds are transferred to the Company's external bank account. Amounts due from BATIF are $10.1 million and $16.2 million at December 31, 2016 and 2015, respectively.

(4) Revolving Credit Facility

On December 7, 2016, the Company entered into a $50 million Uncommitted Revolving Credit Facility with Brown & Williamson Holdings, Inc. (BWH), a BHI affiliate, that expires on December 7, 2018. As of December 31, 2016, there have been no drawdowns on this facility. The interest rate is floating based on London Interbank Offered Rate (LIBOR) plus 0.425%.

(5) Contingent Liabilities

On December 9, 2011, the Company ceased to be a party to the £15 billion Euro Medium Term Note Programme (the Programme) under which the issuers, that also include BATIF, B.A.T. Netherlands Finance B.V. and British American Tobacco Holdings (The Netherlands) B.V., can from time to time issue notes in amounts not to exceed a total of £15 billion or its equivalent in other currencies. The payments of all amounts in respect of any notes issued under the Programme prior to December 9, 2011 are unconditionally and irrevocably guaranteed by BAT and each of the issuers (except where it is the relevant issuer). Any notes issued under the Programme on or after December 9, 2011 are not guaranteed by the Company. The Company does not maintain a guarantee liability related to its guarantees with respect to the Programme. At December 31, 2016 and 2015, there were no notes issued by the Company outstanding under the Programme, but other issuers had notes outstanding of which the Company was a guarantor in the amount of approximately $5.8 billion and $6.9 billion respectively, plus accrued interest, which represents the maximum potential exposure (at applicable year-end exchange rates) had the relevant issuers defaulted as of December 31, 2016 or 2015.

(6) Subsequent Events

On January 17, 2017, BAT announced the agreed terms of a recommended offer for the acquisition of the remaining 57.8% of Reynolds American Inc. (RAI) not already owned by BAT. RAI shareholders will receive for each RAI share $29.44 in cash and 0.5260 BAT ordinary shares which shall be represented by BAT American Depositary Receipts (ADRs) listed on the New York Stock Exchange (NYSE).

The parties expect the transaction to close during the third quarter of 2017 subject to: obtaining affirmative votes from BAT and RAI shareholders; obtaining anti-trust approvals in the US and Japan; registration of BAT shares with the SEC; approval of the BAT shares for listing on the London Stock Exchange (LSE) and the BAT ADRs on the NYSE; and other customary conditions. The completion of the merger is not subject to any financing condition.

Following the announcement that BAT agreed to the terms in relation to the proposed acquisition, the Company and BATIF entered into a $25 billion acquisition facility with a syndicate of banks with BAT as Guarantor. The facility is split into four tranches as follows: two bridge facilities of $15 billion and $5 billion maturing in 2018 and 2019, respectively (each with two six-month extensions at BAT's option), $2.5 billion term loan maturing in 2020 and $2.5 billion term loan maturing in 2022. BAT intends to refinance the bridge facilities through debt issuance in the capital markets.

In order to manage the Company's interest rate risk on expected future debt issuance in the capital markets, the Company has entered into a series of interest rate swaps with BATIF in 2017.

Also, in connection with the proposed acquisition, the Company, along with other members of the BAT Group and with BAT as Guarantor, entered into a two-tranche £5.68 billion forward starting revolving credit facility, which consists of a £2.84 billion 364-day revolving credit facility (with a one-year extension option and a one-year term-out option), and a £2.84 billion revolving credit facility, maturing in 2021.

The Company drew down $11.5 million and $10.0 million on its Revolving Credit Facility with BWH on January 23, 2017 and January 31, 2017, respectively.

The Company has performed an evaluation of subsequent events through April 19, 2017, which is the date the financial statements were available to be issued, and determined that there were no other items to disclose.

REGISTERED OFFICE OF THE ISSUER

B.A.T Capital Corporation
103 Foulk Road
Suite 120
Wilmington, Delaware 19803
United States
(Tel: +1 (302) 691 6323)

REGISTERED OFFICES OF THE GUARANTORS

British American Tobacco p.l.c.
Globe House
4 Temple Place
London WC2R 2PG
United Kingdom
(Tel: +44 (0)20 7845 1000)

B.A.T. International Finance p.l.c.
Globe House
4 Temple Place
London WC2R 2PG
United Kingdom
(Tel: +44 (0)20 7845 1000)

British American Tobacco Holdings (The Netherlands) B.V.
Handelsweg 53A
1181 ZA Amstelveen
The Netherlands
(Tel: +31 (0)20 540 6911)

B.A.T. Netherlands Finance B.V.
Handelsweg 53A
1181 ZA Amstelveen
The Netherlands
(Tel: +31 (0)20 540 6911)

Reynolds American Inc.
401 North Main Street
P.O. Box 2990
Winston-Salem, North Carolina 27102-2990
(Tel: +1 (336) 741-2000)

TRUSTEE

Wilmington Trust, National Association
Global Capital Markets
50 S. 6th Street, Suite 1290
Minneapolis, MN 55402
United States

PAYING AGENT, TRANSFER AGENT, REGISTRAR, AND CALCULATION AGENT

Citibank, N.A., London Branch
Citigroup Centre
Canada Square
Canary Wharf
London E14 5LB
United Kingdom

LEGAL ADVISORS TO THE ISSUER AND GUARANTORS

as to United States law

Cravath, Swaine & Moore LLP
One Ropemaker Street
London EC2Y 9HR
United Kingdom

as to English law

Linklaters LLP
One Silk Street
London EC2Y 8HQ
United Kingdom

as to Dutch law

Stibbe N.V.
Beethovenplein 10
1077 WM Amsterdam
The Netherlands

LEGAL ADVISORS TO THE INITIAL PURCHASERS

as to United States law

Davis Polk & Wardwell London LLP
5 Aldermanbury Square
London EC2V 7HR
United Kingdom

AUDITORS

Independent Auditors and Reporting Accountant

KPMG LLP
15 Canada Square
London E14 5GL
United Kingdom

Auditors

PricewaterhouseCoopers LLP
1 Embankment Place
London WC2N 6RH
United Kingdom

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