British American Tobacco

Delivering today Investing in tomorrow

Annual Report 2016

Annual Report 2016

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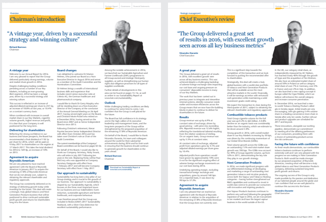

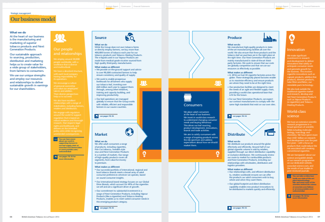

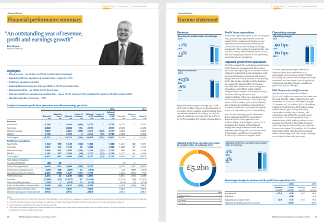

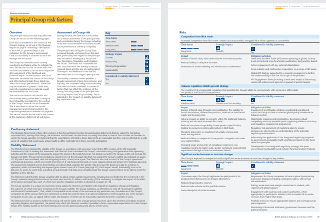

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British American Tobacco p.l.c. (No. 3407696)
Annual Report 2016

This is the Annual Report of British American Tobacco p.l.c. (the Company) and the British American Tobacco Group, comprising the Strategic Report, Directors' Report and the audited Financial Statements for the year ended 31 December 2016. It has been drawn up and is presented in accordance with, and reliance upon, applicable English company law. The liabilities of the Directors in connection with this report shall be subject to the limitations and restrictions provided by such law.

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

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

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

Cautionary statement

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

Overview

Our year in numbers

British American Tobacco is a global tobacco and Next Generation Products company with brands sold in over 200 markets, employing around 50,000 people worldwide.

We make the cigarette chosen by one in eight of the world's one billion adult smokers and have a portfolio of innovative tobacco and nicotine-based products, offering consumers potentially less risky alternatives to conventional cigarettes.

With our geographic diversity, strong brands, talented people and a proven strategy, the Group is well placed to continue delivering value for shareholders today while investing in tomorrow.

Group cigarette volume
665bn
+0.2% (-0.8% organic[1])
2015: 663bn

Group share of Key Markets
+50 bps
bps = basis points
KPI

Global Drive Brands' (GDBs) cigarette volume
324bn
+7.5%

Global Drive and Strategic Brands' (GDSBs) total volume
346bn
+7.2%
KPI

Reported revenue
£14,751m
+12.6%
2015: £13,104m

Revenue at constant rates[2]
£14,008m
+6.9%
2015: £13,104m
KPI

Profit from operations
£4,655m
+2.2%
2015: £4,557m

Adjusted profit from operations[3] at constant rates[2]
£5,197m
+4.1% (+10% excl. trans FX[4])
2015: £4,992m
KPI

Adjusted diluted earnings per share[3]
247.5p
+18.8%
2015: 208.4p
KPI

Adjusted diluted earnings per share[3] at constant rates[2]
230.0p
+10.4%
2015: 208.4p
KPI

Basic earnings per share
250.2p
+8.4%
2015: 230.9p

Total dividends per share
169.4p
+10.0%
2015: 154.0p

Cash generated from operations at constant rates[2]
£2,918m
+21.3%
2015: £2,405m (excl. FII GLO)[5]
KPI

Operating cash flow conversion ratio
93%
2015: 92%
KPI

Total shareholder return (TSR) (compound annual growth rate)
16.1% 2014–2016
KPI

We use these measures and indicators to assess our performance. To ensure management's focus is aligned with the interests of our shareholders, our KPIs are reflected in our management incentive schemes. Although our business measures are not directly included in these incentives, they reflect our performance, improve the quality of our business and contribute to shareholder value.

Notes:
1. Organic excludes contributions by TDR, Blue Nile, Ten Motives and CHIC. Please refer to note 24 on the Financial Statements.
2. The term 'Constant rates' provides the information based on a re-translation, at prior year exchange rates, of the current year information. See page 25 for the major foreign exchange rates.
3. Adjusted profit from operations is derived after excluding the adjusting items from the profit from operations. These items include restructuring and integration costs, amortisation and impairment of trademarks and similar intangibles, and a payment and release of a provision relating to non-tobacco litigation (see page 25).
4. Estimate to exclude transactional foreign exchange on cost of sales.
5. 2015 cash generated from operations included a one-off receipt in relation to Franked Investment Income Group Litigation Order (FII GLO), which is not treated as part of on-going cash generation.

For the avoidance of doubt – all variances in this document are calculated based upon the absolute number.

Overview

Our global business

Our heritage

British American Tobacco was founded in 1902 and was first listed in 1912. Today, we are one of the top five companies listed on the London Stock Exchange by market capitalisation. We also have a secondary listing on the Johannesburg Stock Exchange.

With factories in 42 countries and offices all around the world, we have long played a significant role in the local communities where we operate across the globe. We are proud that we are frequently rated in many countries as a top employer.

Traditional tobacco products are our core business. However, we are also committed to developing and selling potentially less risky alternatives to regular cigarettes. These Next Generation Products include Vapour Products, like e-cigarettes, and Tobacco Heating Products.

Our products

Traditional tobacco products

Our core tobacco product range includes cigarettes, Fine Cut (roll-your-own and make-your-own tobacco) and Swedish-style snus. Using insights from our consumers, we continue to develop high-quality products and market-leading innovations to differentiate our brands.

Next Generation Products

We also market and sell a range of innovative Next Generation Products, the term we use to describe new types of tobacco and nicotine products. We are currently focusing on two distinct categories – Vapour 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.

see pages 10–11 to learn more

Our leading brands

Our five Global Drive Brands – Dunhill, Kent, Lucky Strike, Pall Mall and Rothmans – play a key role in our growth strategy. These leading brands continued to drive volume and share growth in our markets worldwide in 2016.

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

Our key Next Generation Product brands include Vype, our range of Vapour Products, and glo, our Tobacco Heating Product.

Dunhill

Volume

57bn -3.3% 2015: 59bn

Market share

Flat

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

Kent

Volume

66bn +1.0% 2015: 66bn

Market share

+10 bps

Kent symbolises progress through technology in the cigarette category and stands out as the most innovative and forward-looking brand in the industry. It is a pioneering brand, which has led the way since 1952.

Lucky Strike

Volume

36bn +13.5% 2015: 32bn

Market share

+10 bps

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

Pall Mall

Volume

92bn +0.1% 2015: 92bn

Market share

+10 bps

Pall Mall is the third biggest cigarette brand in the world. For more than 115 years, its core proposition has been centred on offering adult smokers round the world a combination of value and high quality.

Rothmans

Volume

73bn +36.9% 2015: 52bn

Market share

+70 bps

Rothmans is an iconic brand established in London in 1890. A timeless classic with high-quality standards, Rothmans is finding increasing appeal among adult smokers worldwide thanks to a contemporary proposition.

Our people

The Group's continuing success is only possible thanks to the nearly 50,000 talented people across the globe who work with farmers, in our factories, in city offices and out on the road supporting retailers. This total involvement in the whole tobacco supply chain – from seed to smoke – and the passion for what we do is what sets us apart.

Our products are made all over the world and it is essential to our continuing success that we employ a diverse range of people and cultures. The international nature of our business is reflected in the nationalities of our people – in 2016, 74 nationalities were represented at our London head office.

We are also proud to partner with over 90,000 contracted tobacco farmers worldwide. While we do not employ them directly, they represent an important part of our business.

see pages 13–14 to learn more

Our sustainable approach

Our approach to sustainability is embodied in our Sustainability Agenda, which is about creating shared value for both our shareholders and our stakeholders in wider society. It focuses on the three key areas that have the greatest significance to our business and our stakeholders:

- Harm reduction: We are committed to researching, developing and commercialising less risky alternatives to regular cigarettes.
- Sustainable agriculture and farmer livelihoods: We are committed to working to enable prosperous livelihoods for all farmers who supply our tobacco leaf.
- Corporate behaviour: We are committed to operating to the highest standards of corporate conduct and transparency.

see pages 15–16 to learn more

Our geographic diversity

With brands sold in over 200 markets, we have strong market positions in each of our four regions. Our Key Markets, shown below, account for around 80% of both our total volume and Group profit.

Provided the acquisition of Reynolds American Inc. (Reynolds American) proceeds, we will have a strong market position in the United States and our number of principal associate companies will be reduced to one – ITC Ltd in India. We also have a joint operation, CTBAT, with China National Tobacco Corporation.

55+
countries where we are market leader

44
cigarette factories in 42 countries

Key Markets

Americas
Argentina
Brazil
Canada
Chile
Colombia
Mexico

see page 18 to learn more

Western Europe
Belgium
Czech Republic
Denmark
France
Germany
Italy
Netherlands
Poland
Romania
Spain
Switzerland
United Kingdom

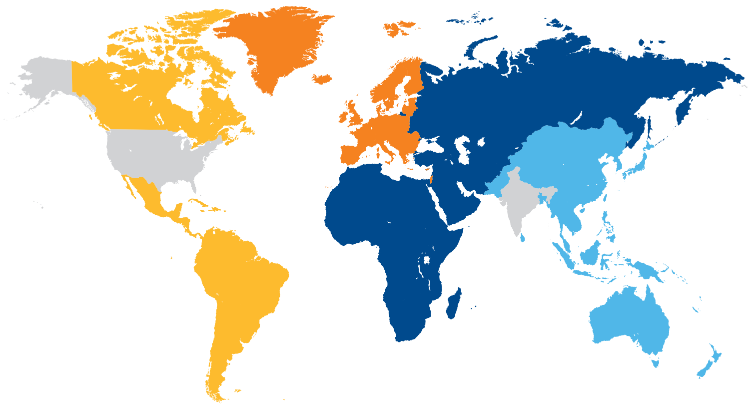
see page 18 to learn more

Eastern Europe, Middle East and Africa
Algeria
Egypt
GCC
Iran
Iraq
Kazakhstan
Morocco
Nigeria
Russia
South Africa
Turkey
Ukraine

see page 19 to learn more

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

see page 19 to learn more



Chairman's introduction

"A vintage year, driven by a successful strategy and winning culture"

Richard Burrows
Chairman

A vintage year

Welcome to our Annual Report for 2016. I am very pleased to report that the Group delivered particularly strong earnings, volume and market share growth in 2016.

Despite challenging trading conditions persisting across a number of our Key Markets, including an ever-growing illicit segment, 2016 has been a vintage year, driven by a successful strategy and winning culture.

This success is reflected in an increase of adjusted diluted earnings per share to 247.5p, an increase of 18.8% on last year, or 10.4% on a constant currency basis.

When combined with increases in overall market share in our Key Markets, cigarette volume growth, higher revenue and profit, it is clear that your Company is well positioned for the long term.

Delivering for shareholders

Reflecting the strong confidence in our business and future prospects, the Board has recommended a final dividend of 118.1p per share for 2016, which will be paid on 4 May 2017 to shareholders on the register at 17 March 2017. This takes the total dividend for 2016 to 169.4p, an increase of 10% on 2015.

Agreement to acquire Reynolds American

We are very pleased to have reached agreement with the Board of Reynolds American in January 2017 to acquire the remaining 57.8% of Reynolds American that we do not already own, subject to obtaining the relevant shareholder and regulatory approvals.

The Group has consistently delivered on its strategy of delivering growth today while investing for the future. This deal will create a stronger, truly global tobacco and Next Generation Products business that will be positioned to drive continued sustainable profit growth and returns for shareholders long into the future.

Board changes

I am delighted to welcome Dr Marion Helmes, who joined our Board as a Non-Executive Director in August 2016 and serves as a member of the Audit Committee and the Nominations Committee.

Dr Helmes brings a wealth of international business skills and experience that includes recent senior executive roles at Celesio AG, the German healthcare and pharmaceutical company.

I would like to thank Dr Gerry Murphy who will be standing down as a Non-Executive Director of the Company at the conclusion of the Annual General Meeting on 26 April 2017, having served eight years on the Board, and Christine Morin-Postel who retired on 6 December 2016, having served on the Board since 2007 and as Senior Independent Director since 2013.

Following Christine's retirement, Kieran Poynter became Senior Independent Director with effect from October 2016 and has taken over Christine's role as Chair of the Audit Committee.

The current memberships of the Companys' Board committees can be found on pages 42–56.

On behalf of the Board, I would also like to thank our Company Secretary, Nicky Snook, who will retire in July 2017 following ten years in the role. Replacing Nicky will be Paul McCrory who was appointed as Company Secretary Designate with effect from 1 February 2017 and will become Company Secretary with effect from 1 May 2017.

Our approach to sustainability

Sustainability has long been a key pillar of our Group strategy and is crucial to the growth of our business. Our approach to sustainability is shaped by our Sustainability Agenda, which focuses on the three most important issues for our business and our stakeholders: harm reduction, sustainable agriculture and farmer livelihoods, and corporate behaviour.

I was therefore proud that the Group was included in RobecoSAM's 2017 Sustainability Yearbook, with a Silver Class distinction for excellent sustainability performance.

Among the notable achievements in 2016, we launched our Sustainable Agriculture and Farmer Livelihoods (SAFL) programme to all Group-owned and strategic third-party suppliers, as well as strengthening our human rights due diligence processes for all types of suppliers worldwide.

Further details of developments in this area can be found on pages 15–16, as well as online in our Sustainability Report at www.bat.com/sustainability.

Outlook

While challenging trading conditions are likely to continue for some time to come, I am confident that the Group is well placed for the future.

The Board has full confidence in its strategy and in the high calibre of its executive leadership and management team, and the long-term prospects of the Group will be strengthened by the proposed acquisition of the remaining 57.8% of Reynolds American.

On behalf of the Board, I would like to thank Nicandro Durante, his team and colleagues around the world for their substantial achievements during 2016 and for their work in ensuring that the business should continue to generate growth for shareholders in the years ahead.

Richard Burrows
Chairman

Download our Sustainability Report at www.bat.com/sustainability

Strategic management

Chief Executive's review

"The Group delivered a great set of results in 2016, with excellent growth seen across all key business metrics"

Nicandro Durante
Chief Executive

A great year

The Group delivered a great set of results in 2016, with excellent growth seen across all key business metrics. This was achieved despite a challenging backdrop of adverse foreign exchange rates impacting our cost base and ongoing pressure on consumers' disposable income in many of our Key Markets.

The work that has been carried out in previous years to integrate and streamline internal systems, identify consumer needs earlier and increase efficiencies across the Group means that we now have the building blocks in place to continue to deliver for shareholders in the future.

Results

Group revenue was up by 6.9% at constant rates of exchange, driven by good pricing – with price mix exceeding 6%. Reported revenue was 12.6% higher, reflecting the translational tailwind resulting from the relative weakness of sterling. On an organic basis, Group revenue was up by 5.3% at constant rates.

At constant rates of exchange, adjusted profit from operations grew by 4.1% and adjusted diluted earnings per share grew by 10.4%.

Adjusted profits from operations would have grown by approximately 10% were it not for the significant ongoing effect of adverse foreign exchange movements on our cost base during 2016.

Underlying operating margin, excluding transactional foreign exchange and acquisitions, grew by around 160 bps. On a reported basis, it was down by 90 bps to 37.2%.

Agreement to acquire Reynolds American

I am very pleased that we reached an agreement with the Board of Reynolds American in relation to the acquisition of the remaining 57.8% of Reynolds American that the Group does not currently own.

This is a significant step towards the completion of this transaction and we look forward to putting the recommended offer to shareholders.

Strategically, this deal will create a truly global business with a world-class portfolio of tobacco and Next Generation Products that will be available across the most attractive markets in the world. Financially, it will be earnings accretive with enhanced cash generation while maintaining a solid investment grade credit rating.

We expect the transaction to close during the third quarter of 2017, subject to obtaining the relevant shareholder and regulatory approvals.

Combustible tobacco products

Total Group cigarette volume for the full year was up 0.2% to 665 billion. A 0.8% decline on an organic basis was considerably better than the industry, which we estimate to be down around 3.0%.

Strong growth in 2016, with overall market share in our Key Markets increasing by 50 bps, was driven by the continuing momentum of our Global Drive Brands (GDBs).

Total volume growth across the GDBs was an outstanding 7.5% and total market share growth was 100 bps. The GDBs now account for 49% of Group cigarette volume, up from 32% in 2011, demonstrating the key role they play in our growth strategy.

Next Generation Products

In 2016, we made significant progress with our differentiated strategy of developing and marketing a range of outstanding next generation tobacco and nicotine products, across both the Vapour and Tobacco Heating categories – having further strengthened our R&D capabilities and continued to invest in world-class science to provide our consumers with innovative and inspiring products.

Our Vapour Products business continues to perform very well and, following the geographic expansion of Vype in 2016, we are now present in ten markets and have the largest vapour business in the world outside of the US.

In the UK, our category retail share, as independently measured by AC Nielsen, has reached nearly 40% through the growth of Vype and the acquisition of Ten Motives. We also have an estimated market share of around 50% in Poland as well as category retail share of over 7% in Germany, over 4% in France and over 2% in Italy. In addition, we also launched a new vaping concept in Europe called the Vype Pebble, which we believe will enhance the overall category and increase consumer penetration.

In December 2016, we launched a new-to-world Tobacco Heating Product called glo in Sendai, Japan. Initial results are very encouraging, with glo gaining 5.4% volume share in a leading convenience store chain in Sendai after only ten weeks. Further roll-out and product upgrades are scheduled for 2017 and beyond.

These innovations, alongside our exciting pipeline, demonstrate our commitment to meeting all of the differing preferences of our consumers, providing them with a choice of outstanding products across the risk continuum.

Facing the future with confidence

As these results demonstrate, our combustible tobacco business continues to perform extremely well and I am very pleased with the progress we are making in Next Generation Products. Both would be made stronger by our proposed acquisition of Reynolds American, creating what will become a truly global tobacco and Next Generation Products company, delivering sustained long-term profit growth and returns.

The ongoing success of the Group is only made possible by the passion and dedication of our talented people around the globe and I am confident that we are well placed to continue this success into the future.

Nicandro Durante
Chief Executive

Strategic management

Our vision and strategy

Our strategy enables our business to deliver growth today, while continuing to invest in our future. Combustible products remain at the core of our business and will continue to provide us with opportunities for growth. However, we also see substantial growth opportunities in the Next Generation Products category and are making significant progress in the commercialisation and development of a range of products which offer consumers potentially less risky alternatives to conventional cigarettes.

Our vision

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

Satisfying consumer moments

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

Tobacco and beyond

The second part of our vision – tobacco and beyond – recognises the strength of our traditional tobacco business and the opportunities we see in Next Generation Products. This is a great potential business opportunity because consumers are looking for choices and product categories in which we are uniquely placed to succeed.

Our mission

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

Champion informed consumer choice

We need to continue to ensure that our adult consumers are fully aware of the choices they are making when they purchase our products. We recognise that we have a responsibility to offer a range of products across the risk continuum but we will also defend people's right to make an informed choice.

Deliver our commitments to society

As society changes and priorities and needs shift, we must be ready to meet new challenges and take advantage of new opportunities. We are a major international business and with this status comes responsibilities such as developing and marketing less risky products, being open about the risks of all our products, supporting agricultural communities in leaf-growing areas worldwide and minimising our impact on the environment.

Strategic focus areas

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

Growth page 10

Developing brands, innovations and new products to meet consumers' evolving needs.

Productivity page 12

Effectively deploying resources to increase profits and generate funds for investment.

Winning Organisation page 13

Ensuring we have great people, great teams and a great place to work.

Sustainability page 15

Ensuring a sustainable business that meets stakeholders' expectations.

Read about our industry page 7

Guiding Principles

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

Enterprising Spirit

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

Open Minded

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

Freedom Through Responsibility

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

Strength from Diversity

Our management population comprises people from over 140 nations, giving us unique insights into local markets and enhancing our ability to compete across the world. We respect and celebrate each other's differences and enjoy working together. We harness diversity – of our people, cultures, viewpoints, brands, markets and ideas – to strengthen our business. We value what makes each of us unique.

Strategic management

Global market overview

The global tobacco industry sells around 5,600 billion cigarettes each year and is valued at an estimated US$770 billion. The market is also one of the most highly regulated in the world, with tobacco subject to extensive product and taxation requirements in nearly all countries and markets. New tobacco and nicotine products aimed at reducing the risks associated with smoking conventional cigarettes are also being widely developed and commercialised.

Global tobacco market

There are an estimated one billion adult smokers around the world, consuming some 5,600 billion cigarettes a year. The value of the global tobacco market is estimated at some US$770 billion, of which the global cigarette market is valued at around US$700 billion.[1]

Outside of China, the four biggest tobacco manufacturers – British American Tobacco, Imperial Brands, Japan Tobacco International and Philip Morris International – account for the vast majority of the total market.

While the tobacco industry is subject to an array of global pressures and market volatility, the overall value of the cigarette market continues to grow. This is despite overall cigarette volume continuing to decline year-on-year.

The tobacco industry also remains a substantial contributor to the economies of many countries and the livelihoods of millions of people across the globe, both directly and indirectly.

Global Next Generation Products market

While international tobacco manufacturers often use differing terminology, Next Generation Products (NGPs) can be broadly divided into two categories as follows:

1. Vapour Products (including e-cigarettes) – battery-powered electronic devices that heat a solution to create a vapour which can be inhaled.
2. Tobacco Heating Products – devices designed to work with specifically engineered cartridges, containing tobacco, to deliver a real tobacco taste and aroma.

While still a nascent market, the global Vapour Products category is the largest of the two types and continues to grow at a significant rate. 2015 estimates place a value of US$8 billion on the global market, with 29 million people estimated to be vaping across the world.[1]

Today, Tobacco Heating Products are a much smaller category but one that is growing quickly in Japan. The category is expanding to other markets, with a limited number of products now available.

The increasing variety of product platforms available to consumers make growth predictions challenging, but NGPs are likely to continue to experience significant growth.

Key industry risks

Regulation – 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.

Restrictions on the manufacture, sale, marketing and packaging of tobacco products are in place in nearly all countries and markets. Such restrictions include the introduction of plain packaging, product-specific regulation, graphic health warnings on packs, tougher restrictions on smoking in enclosed public places and bans on shops displaying tobacco products at the point of sale.

Much of the recent development in regulation at a global level has been driven by the World Health Organization Framework Convention on Tobacco Control (FCTC), a global treaty concerning tobacco control. The FCTC came into force in 2005 and contains provisions aimed at reducing tobacco consumption and toxicity. To date, the FCTC has been ratified by 180 countries.

More recently, significant debate has been generated regarding the appropriate regulation of NGPs, including of the nicotine liquids used in Vapour Products. While this nascent category has grown in size and complexity in a relatively short period of time, a consensus framework for regulating and taxing it has yet to emerge.

Litigation – Litigation continues in a number of forms against the tobacco industry with the most common being third-party reimbursement cases, class actions and individual lawsuits.

Special factors that led to litigation in the US and Canada are not typically replicated in other countries, which is why large volume and high-value litigation has not spread to other parts of the globe.

The industry has a proven track record of defending its rights and dealing with risks such as these.

Illicit tobacco – Product taxation in the form of excise remains a significant source of revenue to the majority of governments worldwide. This can lead some to view the industry as a potential source of extra funds during difficult economic times.

It is estimated that governments collect some US$269[2] billion in excise on the sale of tobacco. However, sudden and steep increases in tobacco excise taxes can lead to an increase in tobacco trafficking, increasing the likelihood of governments receiving less revenue from excise.

The illegal market for tobacco products is an increasing issue for governments and the industry across the world. It is estimated to account for some 460 billion cigarettes[1] and deprives national treasuries of billions in legitimate taxes.

Efforts to tackle the issue of illicit tobacco at industry and government levels have seen some success in recent years. However, the relative punishments versus the profits for illegally selling tobacco products makes them an appealing prospect for criminals.

Further details of the industry risks outlined in this section, and our response to them, are available in the Principal Group risk factors section.

see pages 26–30 to learn more about the Principal Group risk factors

Notes:
1. Source: Euromonitor International.
2. Source: WHO estimates for 2013–14.

Strategic management

Our business model

What we do

At the heart of our business is the manufacturing and marketing of superior tobacco products and Next Generation Products.

Our sustainable approach to sourcing, production, distribution and marketing helps us to create value for a wide group of stakeholders, from farmers to consumers.

We use our unique strengths and employ our resources and relationships to deliver sustainable growth in earnings for our shareholders.

Our people and relationships

We employ around 50,000 people worldwide, with a workforce that is diverse and multicultural.

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 and abilities. Their diverse perspectives help us to succeed.

We also have excellent relationships with a range of stakeholders, including farmers, retailers and distributors.

We engage with regulators around the world to support regulation that is based on robust evidence and thorough research, that respects legal rights and livelihoods, and delivers on the intended policy aims while recognising unintended consequences.

You can learn more about our work in supporting farmers in our leaf supply chain at www.bat.com/farmervideo or www.youtube.com/welcometobat

see pages 10–16 for more information

Source

What we do

While the Group does not own tobacco farms or directly employ farmers, we buy more than 400,000 tonnes of tobacco each year for our tobacco products and Tobacco Heating Products. The e-liquids used in our Vapour Products are made from medical grade nicotine sourced from high quality third-party manufacturers.

What makes us different

- We provide on-the-ground support and advice to over 90,000 contracted farmers to help ensure consistency and quality of supply.
- We work to enable prosperous livelihoods for all farmers who supply our tobacco leaf, investing over £60 million each year to support them through, among other initiatives, training and capacity building, and improving productivity.
- Our leaf operations are managed globally to ensure that the Group works with reliable, efficient and responsible farmers in our source countries.

see pages 10–16

Market

What we do

We offer adult consumers a range of products, including cigarettes, Fine Cut tobacco, Swedish-style snus and Next Generation Products in a number of markets. Our range of high-quality products covers all segments, from value-for-money to premium.

What makes us different

- Our successful portfolio of international, regional and local tobacco brands meets a broad array of adult consumer preferences wherever we operate, based on sound consumer insights.
- Our international brand strategy focuses on our Global Drive Brands, which account for 49% of the cigarettes we sell and are a significant driver of growth.
- Our commitment to substantial investment in a range of Next Generation Products, including Vapour Products (like e-cigarettes) and Tobacco Heating Products, enables us to meet varied consumer needs in this emerging product category.

see pages 10–16

Consumers

We place adult consumers at the heart of our business. We invest in world-class research to understand changing consumer needs and buying behaviour. This drives our leaf sourcing, product development, innovations, brands and trade activities.

We aim to satisfy consumers with a range of inspiring products across the risk spectrum and address expectations about how we should market them.

Produce

What we do

We manufacture high-quality products in state-of-the-art manufacturing facilities all over the world. We also ensure that these products and the tobacco leaf we purchase are in the right place at the right time. Our Next Generation Products are mainly manufactured in state-of-the-art third-party factories. We work to ensure that our costs are globally competitive and that we use our resources as effectively as possible.

What makes us different

- In 2016 we had 44 cigarette factories across the globe. These strategically placed factories enable us to maximise efficiency and ensure products are where they need to be at the right time.
- Our production facilities are designed to meet the needs of an agile and flexible supply chain, providing a world-class operational base that is fit for the future.
- For our Next Generation Products, we expect our contract manufacturers to comply with the same high standards that exist on our own sites.

see pages 10–16

Distribute

What we do

We distribute our products around the globe effectively and efficiently. Around half of our global cigarette volume is sold by retailers, supplied through our direct distribution capability or exclusive distributors. We continuously review our route to market for combustible products and Next Generation Products, including our relationships with wholesalers, distributors and logistics providers.

What makes us different

- Our relationships with, and efficient distribution to, retailers worldwide ensures we can offer the products our adult consumers wish to buy, where and when they want them.
- Our global footprint and direct distribution capability enables new product innovations to be distributed to markets quickly and efficiently.

see pages 10–16

Innovation

We make significant investments in research and development to deliver innovations that satisfy or anticipate consumer needs and generate growth for the business. This involves cigarette innovations such as capsule products, additive-free products, slimmer products, tube filters and Reloc, our resealable pack technology.

We also look outside the traditional cigarette market and research, develop and test Next Generation Products such as Vapour Products (e-cigarettes) and Tobacco Heating Products.

World-class science

We have an extensive scientific research programme in a broad spectrum of scientific fields including molecular biology, toxicology and chemistry. We have spent more than US$1 billion on research and development over the past five years – with a focus on products that could reduce the risk associated with smoking conventional cigarettes.

We are transparent about our science and publish details of our research programmes on our dedicated website, www.bat-science.com, and the results of our studies in peer-reviewed journals.

You can take a video tour inside our state-of-the-art plant biotechnology labs and meet some of the scientists behind the science at www.bat.com/labtour or at www.youtube.com/welcometobat

see pages 10–16 for more information

Strategic management

Delivering our strategy

Growth

Our brands delivered further growth in 2016 as we continued to invest in opportunities in Key Markets and Next Generation Products.

Highlights during the year

- Group revenue grew by 6.9% at constant rates of exchange.
- Price mix of over 6%, up from 5.9% in 2015.
- Market share in Key Markets up by over 50 bps.
- Now the world's largest vapour business outside of the US.

Winning in combustibles

Group cigarette volume grew by 0.2% to 665 billion. Excluding acquisitions, volume fell on an organic basis by 0.8%, against an estimated industry decline of around 3.0%. Total tobacco volume was 0.1% higher than 2015.

The Group's cigarette market share in its Key Markets continued to grow strongly, higher by over 50 bps. This was principally driven by our Global Drive Brands (GDBs) which grew volume by 7.5% and market share by 100 bps. Volume growth of the GDBs, including strategic brands (together known as GDSBs), was up 7.2%.

Group revenue was up by 6.9% at constant rates of exchange, or by 12.6% at current rates, with the higher growth rate reflecting the translational tailwind as a result of the relative weakness of sterling. On an organic basis, Group revenue was up 5.3%.

Global Drive Brands

Our five leading brands – our GDBs – are Dunhill, Kent, Lucky Strike, Pall Mall and Rothmans.

They play a key role in our growth strategy and now account for 49% of all the cigarettes we sell, up from 32% in 2011.

Dunhill: Volume decreased by 3.3% to 57 billion, with market share flat, driven mainly by industry declines in Malaysia and Brazil, more than offsetting growth in South Korea and the continued growth in Indonesia.

Kent: Volume in 2016 was 66 billion, up by 1.0%, driven by Chile, Turkey, Japan and Russia. Market share was up 10 bps.

Lucky Strike: Market share grew 10 bps, with volume of 36 billion, up 13.5%, with growth in Indonesia, Colombia, Egypt, France, Croatia and Italy and more than offsetting lower volume in Argentina and Russia.

Pall Mall: Volume in 2016 was 92 billion, up 0.1% as growth in Venezuela, Poland, Iran, Mexico and Romania more than offset reductions in Pakistan and the migration to Rothmans in Italy. Market share was up 10 bps.

Rothmans: 2016 saw another year of exceptional growth, with Rothmans increasing volume by 36.9% to 73 billion, driven by Russia, Ukraine, Italy, Nigeria, Turkey and South Korea. Market share was up 70 bps.

Key performance indicators

Reported revenue

£14,751m
+12.6%

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

Target: To grow revenue (also known as Net Turnover or NTO) by 2–5% per year over the medium to long term.

Revenue at constant exchange rates

£14,008m
+6.9%

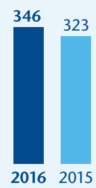
Definition: Gross turnover net of duty, excise and other taxes, translated at constant rates of exchange.

Target: To grow revenue (also known as Net Turnover or NTO) by 2–5% per year over the medium to long term.

KPI

Global Drive and Strategic Brands' (GDSBs) cigarette volume

346bn
+7.2%



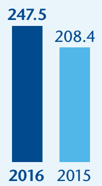
Definition: GDSB volume is calculated as the total volumes of the five GDBs plus strategic brands sold by our subsidiaries.

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

KPI

Adjusted diluted earnings per share (pence)

247.5p
+18.8%



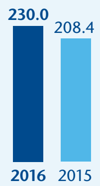
Definition: This is our adjusted diluted earnings per share (EPS) – see note 7 in the Financial Statements.

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

KPI

Adjusted diluted earnings per share at constant rates (pence)

230.0p
+10.4%



Definition: This is our adjusted diluted earnings per share (EPS), translated at constant rates of exchange – see note 7 in the Financial Statements.

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

KPI

Group share of Key Markets

+50 bps

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

Target: To continue to grow market share.

KPI

Premium products

The Group's share of the premium segment was stable. However, our premium volume fell by 5.5% to 170 billion mainly due to declines in Nigeria, Brazil, Malaysia, Pakistan and the GCC. Good growth in premium volume was seen in Turkey, Russia, South Korea and Indonesia.

Local and international brands

Although experiencing a slow decline, our local and international brands continue to play an important role in delivering the Group's Strategy in several Key Markets, including South Africa, Vietnam, Pakistan, Bangladesh and Japan.

International brands (down 9%) include Vogue, Viceroy, Kool, Peter Stuyvesant, Benson & Hedges, State Express 555, Shuang Xi and John Player Gold Leaf. Local brands were down 4.4%.

Innovations[1]

Innovations are an important part of our strategy to provide consumers with a range of exciting and differentiated products from which to choose.

In 2016, growth across these products was 12%, driven by the success of tube filters and the slimmer formats across the GDB portfolio. They now account for 29% of the Group's total reported cigarettes volume, with Innovations as a share of Global Drive Brand volume now 54.2%.

Other Tobacco Products

Other Tobacco Products include cigar and Fine Cut brands, including roll-your-own and make-your-own.

Our cigar brands include the hand-made premium Dunhill Signed Range.

Other Tobacco Products volume fell by 4.8% to 24 billion sticks equivalent due to a reduction in Fine Cut volume in Western Europe.

1. Defined as any Group-manufactured cigarette containing non-standard features such as slims, capsules, Reloc or tubes.

Next Generation Products

In the last five years, the Group has invested over $1 billion in building our Next Generation Products (NGP) business and making available a range of inspiring products that meet the preferences of different consumers.

With the global NGP market estimated to be worth some £15 billion by 2020 (excluding the US), we believe our strategy positions the Group to capture a significant share of this exciting market in the future and will contribute substantially to future growth.

Progress in Vapour Products

Following geographic expansion in 2016, our leading Vapour Product, Vype, is now available in ten markets.

Based on our estimated share of the global vapour market outside the US, we are already the largest international company in the category, having successfully launched a portfolio of products in the five largest vapour markets in Europe. This includes leadership positions in the UK and Poland.

Since launching Vype in the UK in 2013, we now have six different Vype devices available to consumers, as well as a variety of new e-liquid flavours and nicotine strengths, including a nicotine-free option.

In the UK, our category retail share, as independently measured by AC Nielsen, has reached over 37% through the growth of Vype and the acquisition of Ten Motives. We also have an estimated market share of around 50% in Poland as well as category retail share of over 7% in Germany, over 4% in France and over 2% in Italy. We launched our first Vype retail concept store in Milan in 2016, offering consumers a place to not only purchase devices and e-liquids but also learn more about the product range.

In consumer tests, Vype is outperforming its nearest competitor and is seen as a trusted and superior brand.

The newest addition to our portfolio of Vapour Products is the Vype Pebble, which is a small, highly portable device that is simple to use and delivers superior vaping performance. Early consumer uptake of Vype Pebble has been encouraging and we are confident that it will see good growth in 2017.

In 2017, we plan to launch our first Vype device using a radical new vaping technology developed in partnership with an independent inventor. This replaces the current 'coil and wick' system and will give better product performance and satisfaction to consumers.

Progress in Tobacco Heating Products

In December 2016, we launched an advanced yet intuitive Tobacco Heating Product called glo in Sendai, Japan, which provides an experience similar to that of a cigarette but with around 90% less toxicants.

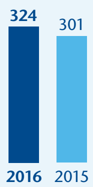
Designed in the UK, the development of glo involved over 100 experts across five continents including scientists, engineers, designers, tobacco experts and toxicologists. The 'one unit, one button' device is simple and intuitive, with one single charge lasting more than 30 sessions based on back-to-back usage.

Early indications are very encouraging, with glo gaining 5.4% share in a leading convenience store chain in Sendai after only ten weeks. Further roll-out and upgrades are scheduled for 2017 and beyond.

Additionally, our iFuse product blends vaping technology with tobacco, which is proving popular in our test market in Romania. In 2017, we will continue to develop the platform.

Global Drive Brands' (GDBs) cigarette volume

324bn
+7.5%



Definition: GDB volume is calculated as the total volumes of the five GDBs.

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

Total shareholder return – annual % (compound annual growth rate 2014–2016)

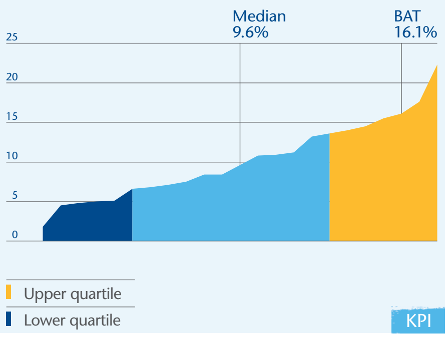
16.1%

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

Target: The Group is focused on increasing shareholder value, which is measured using TSR compared to a fast-moving consumer goods (FMCG) peer group (see page 52 for details). The FMCG comparator group is reviewed annually to ensure it remains both relevant and representative.

KPI

FMCG group – 1 January 2014 to 31 December 2016
The FMCG group comparison is based on three months' average values



KPI

Strategic management

Delivering our strategy continued

Productivity

We are driving towards a more efficient and effective globally integrated organisation by utilising global systems and ways of working. This global integration ensures lowest possible overheads, the most cost-effective and responsive supply chain and that productivity opportunities are fully exploited.

Highlights during the year

- Record productivity savings delivered.
- Globalising operations and improving efficiency through the establishment of Global Leaf Operations Centre in Brazil and Global supply planning centre in Southampton and further expanded shared services for Human Resources and Finance in Romania.
- Continued optimisation of leaf growing and manufacturing locations.

Globalising operations and improving efficiency

Global systems and ways of working across the Group are exploited to minimise our cost base and maximise expertise. Furthermore, by ensuring back-office activities are carried out most efficiently and effectively, the end markets are free to focus their efforts on sales activities. This drive to a globally integrated enterprise is most apparent in our Supply Chain, Human Resources, Finance, Procurement and Information Technology functions.

In line with this strategy, during 2016 the Group set up a Global Leaf Operations Centre in Brazil, a Global supply planning centre in Southampton and further expanded shared services for Human Resources and Finance in Romania. In all cases, these opportunities have been enabled by the Group's single global SAP system.

The final markets, Croatia, Greece, Serbia and Indonesia, came on line to our single system at the end of 2016. Further opportunities to exploit the Group's global integration are being planned through 2017 and beyond as expertise embeds.

The drive towards above-market aggregation is not only expected to reduce cost through less duplication but also ensure the best expertise is exploited throughout the Group. This is considered a key to succeeding when establishing global activities across our combustible and Next Generation Products businesses.

In Supply Chain, the Group is integrated globally such that the single view of future demand ensures resources and investments can be most efficiently prioritised.

This includes machinery investment so that capital expenditure is targeted to the areas of the business with the greatest return on the investment. This global view also improves our ability to react quickly in situations when speed to market will give us a competitive advantage.

Continued strategic investments in new machinery in 2016, supported by our global planning systems and integrated business model, have ensured we deliver 'on time in full' in all our Key Markets at optimal cost, with speed and scale.

Continued optimisation of leaf growing and manufacturing locations

In 2016, we continued to optimise our manufacturing footprint and at the end of the year had 44 cigarette factories in 42 countries.

Factory closures included Porto Alegre in Brazil, completed in 2016, with Malaysia and Germany announced and in progress. This is balanced against a new factory in Iran and Cuba together with the TDR acquisition that included the Kanfanar factory in Croatia. Furthermore, factory expansions in Poland, Romania and Bangladesh show how our sourcing is responsive to increased local volume and innovations demands while remaining cost effective.

We are continually looking to improve the efficiency of all our supply chain with the opportunities to improve our manufacturing operations being a focus in 2016 continuing into 2017. We are realising the benefits of our Integrated Work Systems, a programme that is designed to maximise equipment efficiency while ensuring we maintain high standards of product quality.

The improved equipment efficiency is delivering real benefit in reduced labour and maintenance costs and reduced waste. It is further expected that capital expenditure can be released to invest in further innovation.

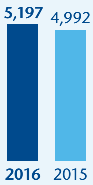
Key performance indicators

Adjusted profit from operations at constant exchange rates

£5,197m

+4.1%

(+10% excl. transactional FX)



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

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

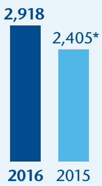
KPI

Cash generated from operations at constant rates

£2,918m

+21.3%

(*2015 excl. FII GLO receipt)



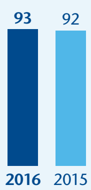
Definition: Cash generated from operations is defined as the free cash flow excluding restructuring costs and dividends and other appropriations from associates, per the alternative cash flow on page 24.

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

KPI

Operating cash flow conversion ratio

93%



Definition: This measures our operating cash flow (see page 24) as a ratio of adjusted operating profit.

Target: To convert between 85 and 95% of our adjusted operating profit to operating cash flow.

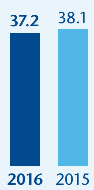
KPI

Business measures

Operating margin

37.2%

-90 bps



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

Target: To increase operating margin by 50–100 bps per annum on average over the medium term.

Record productivity savings

By operating globally, exploiting our systems and driving for results, the Group delivered record productivity savings in 2016.

These savings are returned to the business for re-investment and to increase shareholder return. The following examples show how the Group considers all opportunities in the supply chain including Procurement, Logistics and Leaf Supply:

Procurement – One of the most notable initiatives in 2016 was the tender for the supply of print materials at a global level, which will deliver significant savings over three years. This is an example of how global visibility of forward demand and product specifications in one system has delivered benefit.

International logistics – Whether by road, air or sea, this is now organised and controlled centrally. This facilitates opportunities to negotiate globally with third-party providers for us to benefit from our scale. Furthermore, this maximises the use of return shipments and economic order quantities to ensure maximum efficiency while maintaining the flexibility for fast response to market opportunities.

Leaf operations – These are similarly managed globally to ensure that the Group works with reliable, efficient and responsible farmers in our source countries. Our Global Leaf Pool operation aggregates demand to meet supply across all internationally traded tobacco. This approach balances the lowest possible working capital investment while reducing any exposure to weak crops and guaranteeing the best quality leaf to meet consumer demands.

While transactional foreign exchange rates had a material impact on our cost base in 2016, by continuing to improve our productivity in all areas of our supply chain and elsewhere in the Group, we can increase our profitability and continue to deliver returns to our shareholders today and invest in the future.

Winning Organisation

We enable growth by having a winning organisation: by investing in our people; by attracting the best; and by enhancing the high performing leaders who inspire diverse teams of committed and engaged people in a fulfilling, rewarding and responsible work environment.

Highlights during the year

- Launched our new global graduate programme focused on developing the commercial acumen of our junior talent.
- Accelerated talent development and attraction in growth markets and growth categories.
- Continued to increase the digital reach and engagement of our employer brand 'Bring your Difference'.

Investing in leaders

The long-term culture of the Group has been about developing talent from within, stretching and supporting the high-performing managers who lead the delivery of our strategy. This year, over 93% of our senior appointments were drawn from people already within the business – moves that have helped deliver stronger and more diverse leadership teams and succession plans.

In 2016 we welcomed the first intake into our new global graduate programme – an accelerated 12-month initiative giving emerging talent early commercial responsibility and international experience, supported by collaborative, world-class development. The programme culminates in the global attendees from the 18 countries coming together in London to attend the new 'BAT Academy' in 2017.

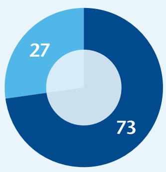
We continue to evolve the portfolio of functional and leadership programmes which drive capability enhancement of our people. An example from this year was the launch of the 'CEO challenge' – a forum for teams of senior leaders to come together to engage the CEO and the Board on transformational change and breakthrough performance.

Business measures

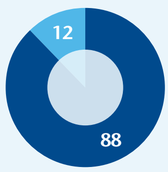
Group diversity

	Total	Male	Female
Main Board	**11**	8	3
Senior managers*	**206**	182	24
Total Group employees	**49,817**	38,811	11,006

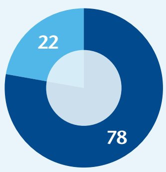
Main Board



Senior managers



Total Group employees



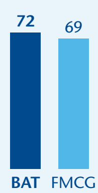
% Male
% Female

Nationalities represented

	Total
Main Board level	**6**
Global headquarters	**74**
Management level globally	**144**

Employee engagement index

72%



BAT	72%
FMCG comparator group	69%

Definition: Results from our 'Your Voice' employee opinion survey, last carried out in 2014, enable us to calculate our employee engagement index – a measure that reflects employee satisfaction, advocacy and pride in the organisation.

Objective: To achieve a more positive score than the norm for FMCG companies in our comparator benchmark group.

* Senior managers are defined here as the members of the Management Board (excluding the Executive Directors) and the directors of the Group's principal subsidiary undertakings. The principal subsidiary undertakings, as set out in the Financial Statements, represented approximately 81% of the Group's employees and contributed around 80% of Group revenue and profit from operations in 2016.

Delivering our strategy continued

Attracting outstanding people

When we do recruit externally, we actively seek those who will provide additional knowledge and skills that will strengthen our teams and ultimately make us a stronger business. In 2016, we significantly enhanced our internal capability to engage and recruit those people who will help us win in growth markets and growth segments.

We continued the digital growth of our employer brand – 'Bring your Difference' – across core social media channels, cementing the industry leadership of our talent brand on LinkedIn.

As competition for talented employees intensifies, people increasingly want to work for businesses with a good corporate reputation, so we are proud to have been ranked among the top five employers in Europe by the Top Employer Institute in 2016, as well as receiving similar accolades in many of the countries in which we operate.

Growth through diversity

Diversity matters to the Group because it makes good commercial sense – having a diverse workforce means we are better able to understand and meet the needs of our global consumers.

We are a diverse employer. There are 144 nationalities represented within our Group, and 36 within our executive cadre. This year we have female executives on all of our senior functional and geographical leadership teams.

However, while we are pleased with the progress we have made in terms of nationality diversity, we recognise that more needs to be done regarding gender diversity and this area will be a priority for us in 2017.

We are focused on initiatives throughout our organisation to drive ownership and accountability, build diverse talent pools and create enablers, supported by an inclusive culture.

Our 'Women in Leadership' programme helps support and accelerate career progression of female talent within the Group. Since 2013, the programme has reached 130 female managers representing all functions and major locations across the Group. We have also developed new 'unconscious bias' training, which is being rolled out to all management employees globally.

Our regions and markets also work to progress the global diversity strategy through on-the-ground initiatives relevant for the local culture and circumstances.

Safe place to work

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

We focus on risk management and assessments, employee training and awareness, and specific initiatives for high risk areas of our business. For example, to further integrate health and safety into manufacturing practices and procedures, we are implementing an internationally recognised management system.

Nearly 70% of total accidents are in trade marketing and distribution (TM&D), where we have over 26,000 drivers out on the road every day who are particularly vulnerable to road traffic accidents (RTAs) and robberies.

Our fleet and driver safety programme focuses on addressing these risks through: enhanced global vehicle specifications and safety controls; driver training to improve skills and hazard perception; tool-kits and practical guidance for management; security protocols and escorts in high-risk locations; efficient route-to-market planning; and tracking progress through quarterly business reviews. As a result, in 2016 we achieved a 14% reduction in accidents in the TM&D area of the business.

Sadly, however, four contractors lost their lives – three in armed robberies and one in a fall from height, and two employees died – one in an RTA and one in a train accident. In addition, two members of the public lost their lives in accidents involving our vehicles.

While this is a reduction in fatalities compared to 2015, any loss of life is a matter of enormous concern to us.

We want to reduce the chances of similar events happening again. As such, we carry out detailed reviews of all reported accidents and fatalities to learn lessons and identify where we can improve our approach to ensure the health and safety of all our employees and contractors.

Equal opportunities for all

We are committed to providing equal opportunities to all employees. We do not discriminate when making decisions on hiring, promotion or retirement on the grounds of race, colour, gender, age, social class, religion, smoking habits, sexual orientation, politics or disability, subject to the inherent requirements of the role to be performed. We are committed to providing training and development for employees with disabilities.

Rewarding people

Reward is a key pillar in ensuring that we have the right people to drive the business forward. Reward is necessarily local and we strongly support this through global frameworks to ensure leading edge policies, processes and technology are available to all markets. Base pay rewards core competence relative to skills, experience and contribution to the Group, while annual bonuses, recognition schemes and ad hoc incentives provide the right mix to ensure that high performance is recognised and rewarded. Further information on the Group's Remuneration Policy for the Executive Directors and the Non-Executive Directors can be found on pages 49–55.

We also offer our UK employees the chance to share in our success via our Sharesave Scheme, Partnership Share Scheme and Share Reward Scheme, and operate several similar schemes for senior management in our Group companies.

Leadership for change

The world is changing fast. The accelerated pace of change – for example, growth of new segments in our industry – demands that our people are ambitious, courageous and resilient; that they learn quickly and are responsive to opportunities; and that they continue to drive and own results. As our organisation evolves, we continue to focus on these traits and on what has served the Group well through its history – having a culture of passionate owners, having people who lead and inspire each other for the journey ahead.

In 2017, we will be running the Group's global employee survey. Our last survey had a response rate of 93% – 11 percentage points higher than the average response rate for this type of survey – with the key Engagement Index score of 72% being 3% higher than the FMCG comparator norm of 69% (see chart on page 13).

This survey conveys the pride which many employees have in working for us and is demonstrable as we have continued to see employee turnover stay below comparator benchmarks.

You can learn more about our Global Graduate Programme at www.bat-careers.com/graduates

Sustainability

Sustainability is a key pillar of our Group strategy and plays a fundamental role in all aspects of our business.

Our sustainability agenda was developed through a detailed materiality process that identified the three key areas that have the greatest significance to our business and our stakeholders.

- Harm reduction: We are committed to researching, developing and commercialising less risky alternatives to regular cigarettes.
- Sustainable agriculture and farmer livelihoods: We are committed to helping enable prosperous livelihoods for all farmers who supply our tobacco leaf.
- Corporate behaviour: We are committed to operating to the highest standards of corporate conduct and transparency.

Read more about how we identified these issues at bat.com/materiality

Highlights during the year

- Launched our new Sustainable Agriculture and Farmer Livelihoods (SAFL) programme.
- Piloted a new integrated human rights due diligence system.
- 47% reduction in carbon dioxide equivalent (CO_2e) emissions from our 2000 baseline.

Sustainability reporting

Find out more about our focus on sustainability in our Sustainability Report 2016.

It is available on our corporate website **www.bat.com/sustainability**

Harm reduction – Next Generation Products

In the world of public health, harm reduction is about developing policies to try to minimise the negative health impacts of a risky activity, without stopping it entirely.

For tobacco, harm reduction means offering potentially less risky alternatives to conventional cigarettes to smokers who cannot, or choose not to, give up.

Read about our progress in NGPs on page 11

Supporting the development of regulation

We continue to take a lead in advocating for proportionate Next Generation Products regulation that has high standards for consumer safety and product quality, while encouraging innovation and availability to enable this important category to grow and deliver its harm reduction potential.

While Next Generation Products are generally considered to be less risky than smoking, nicotine is addictive and no product is 100% safe, so it is important to ensure they do not get into the hands of children and are marketed in a responsible way.

2016 was the first year in which our Vapour Product Marketing Principles, aligned to the UK Committee of Advertising Practice Codes, were in operation.

We are now working on the development of new Marketing Principles for Tobacco Heating Products.

Sustainable Agriculture and Farmer Livelihoods (SAFL)

The farmers we work with are valued business partners, so we want them to feel secure and confident about their future and to be self-sufficient and prosperous.

While our new Sustainable Tobacco Programme (STP) is an industry-wide, top-down compliance process, SAFL is our own grassroots, bottom-up approach to enhancing farmer livelihoods.

Based on an internationally recognised framework, SAFL builds on many examples of good practice from across our leaf supply chain, providing us with the data and information we need to develop a more globally consistent approach, improve strategic decision-making and share best practice for addressing common challenges in different countries.

Our leaf operators conducted a baseline data collection exercise in 2016 against a defined set of indicators which covered a wide range of areas such as farmer income, soil management and tackling child labour. We are now using the results to identify the most material issues for farmers and their communities and develop more effective local actions to meet them.

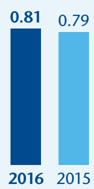
Business measures

Carbon dioxide equivalent (CO_2e)

(tonnes CO_2e per million cigarettes equivalent produced)

0.81

47% lower than 2000 baseline



Definition: We track Group CO_2e in tonnes per million cigarettes equivalent (tCO_2e/MCE) produced.

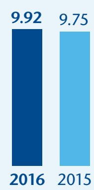
Target: To reduce Group CO_2e in tCO_2e/MCE by 55% by 2025 and by 80% by 2050 against our 2000 baseline.

Group energy use

(gigajoules per million cigarettes equivalent produced)

9.92

16% lower than 2007 baseline



Definition: We track Group energy use in gigajoules per million cigarettes equivalent (GJ/MCE) produced.

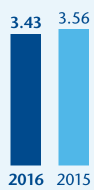
Target: To reduce our energy use to 9.17 GJ/MCE by 2025, 25% lower than our 2007 baseline.

Water use

(cubic metres per million cigarettes equivalent produced)

3.43

29% lower than 2007 baseline



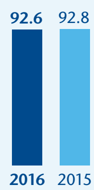
Definition: We track Group water use in cubic metres per million cigarettes equivalent (m^3/MCE) produced.

Objective: To reduce water use to 3.17 m^3/MCE by 2025, 35% lower than our 2007 baseline.

Recycling

(percentage of waste recycled)

92.6%



Definition: We track the total percentage of Group waste reused or recycled against total waste generated.

Objective: To recycle 95% or more by 2025 in each year.

Strategic management

Delivering our strategy continued

Safeguarding human rights

Our Human Rights Policy forms part of our Standards of Business Conduct (SoBC) and details our commitments to no child labour or exploitation of labour, as well as to respect freedom of association, to manage human rights risks and to understand local communities.

We support the UN Guiding Principles on Business and Human Rights and recognise the increased expectations this places on businesses and the wider supply chain. As such, we are continuing to evolve and strengthen our approach, including the roll-out in 2016 of our new Supplier Code of Conduct.

We make it clear to all of our contracted farmers and suppliers that exploitative child labour and other human rights abuses will not be tolerated. Compliance is monitored through the Sustainable Tobacco Programme which covers a range of human rights issues, including child labour, forced labour, fair treatment and grievance mechanisms.

We also provide farmer training and capacity building to raise awareness of human rights issues and run on-the-ground projects in farming communities to address root causes, such as rural poverty, in collaboration with local partners.

Human rights due diligence

The effectiveness of, and compliance with, our Policy commitments are monitored through our human rights due diligence processes.

With the highest risks for human rights abuses in our tobacco leaf supply chain, due diligence is conducted on 100% of our first-tier leaf suppliers through the industry-wide Sustainable Tobacco Programme.

For our 70,000+ other first-tier suppliers, we have been strengthening our existing processes and better aligning them to the UN Guiding Principles. In 2016, we piloted a new integrated system focused on assessing suppliers' human rights risk exposure and then prioritising the highest risk suppliers for self-assessments and on-site audits, followed by working together to implement corrective action plans. We are now conducting a phased roll-out to all our suppliers worldwide.

We are also in the process of reviewing our due diligence processes for our own operations and plan to implement a strengthened approach in 2017.

Corporate behaviour

Responsible marketing

Conventional tobacco products pose serious health risks, so it is vital that they are marketed responsibly wherever they are sold and do not get into the hands of children.

All our marketing is governed by our voluntary International Marketing Principles (IMP) and we target 100% IMP compliance worldwide. The IMP are our minimum standard and will be applied even when they are stricter than local laws. However, if local laws or other voluntary codes in markets are stricter than or override our IMP, then we will abide by those laws or voluntary codes.

In 2016, no incidents of IMP non-compliance were identified through our internal procedures. There were, however, four external allegations made about our marketing practices in relation to local tobacco control and advertising laws. We conducted detailed investigations and found no evidence of any wrongdoing.

In addition to our strict IMP requirement to only market our products to adult smokers, we expect youth smoking prevention (YSP) activities to be conducted in all our markets where feasible and permitted. In 2016, we achieved 100% compliance.

Addressing allegations and incidents in our supply chain

With a global supply chain, issues can sometimes occur. In 2016, this has included two reports from the NGOs Human Rights Watch and Swedwatch into our Indonesian and Bangladeshi leaf supply chains, as well as a complaint by the International Union of Food Workers (IUF) to the UK National Contact Point of the OECD, alleging human rights abuses in our US supply chain.

We take such allegations extremely seriously and are working to further investigate the claims, engage with all relevant stakeholders, and implement actions and joint solutions to address any issues identified.

Also in 2016, 39 people tragically lost their lives in a fire at the factory of a third-party packaging supplier in Bangladesh. The Government of Bangladesh has been leading the compensation process and, working closely with them, we have voluntarily agreed to contribute to their fund.

Modern Slavery Act

Forced labour, servitude, slavery and human trafficking (Modern Slavery) is a growing global issue and businesses have a clear role to play in eliminating it from their operations and supply chains. Our first Modern Slavery Act statement details the steps we are taking to tackle it – bat.com/MSA.

Tackling the illegal tobacco trade

The black market in tobacco involves criminal gangs selling counterfeit cigarettes, cross-border smuggling and engaging in large-scale tax evasion.

As an issue that harms our business, deprives governments of taxes and funds terrorism, we are working collaboratively with law enforcement and working closely with international bodies such as the World Customs Organization, Europol and the OECD Development Task Force on Countering Illicit Trade.

To prevent our products becoming part of this criminal trade, we have robust 'know your supplier and customer' procedures to make sure we do not do business with anyone found to be complicit in tobacco trafficking.

We have also introduced an automated system for tracking and tracing our products as they move through the supply chain, as part of our agreement with the European Commission's Anti-Fraud Office. By the end of 2016, we successfully completed our commitment in the agreement to have this implemented in 18 markets and 11 factories.

Addressing environmental impacts

As a major multinational, we have a responsibility to minimise our impact on the environment. This is not only the right thing to do, it also makes sound business sense for us to use raw materials, energy and water in a sustainable way.

In 2016, we developed a new set of targets to achieve by 2025. We also continue to work towards our long-term target to cut CO_2e emissions by 80% by 2050 and have so far achieved an 47% reduction from our 2000 baseline (see table on page 15). We use the Greenhouse Gas Protocol Corporate Standard to guide our CO_2e reporting methodology (see table below), adopting an equity share approach to defining, consolidating and reporting our Scope 1, Scope 2 and Scope 3 CO_2e emissions.

With 44 factories in 42 countries, the majority of our direct impacts are in our manufacturing operations, so we have a number of initiatives in this area, including investing in energy-efficient technologies, switching to less carbon-intensive fuels and water recycling and rainwater harvesting.

Emissions

	2016	2015
Scope 1 CO_2e emissions (tonnes)	**311,172**	330,495
Scope 2 CO_2e emissions (tonnes)	**374,976**	363,501
Scope 3 CO_2e emissions (tonnes)	**176,015**	182,343
Total (tonnes)	**862,163**	876,339
Intensity (per million cigarettes equivalent)	**0.81**	0.79

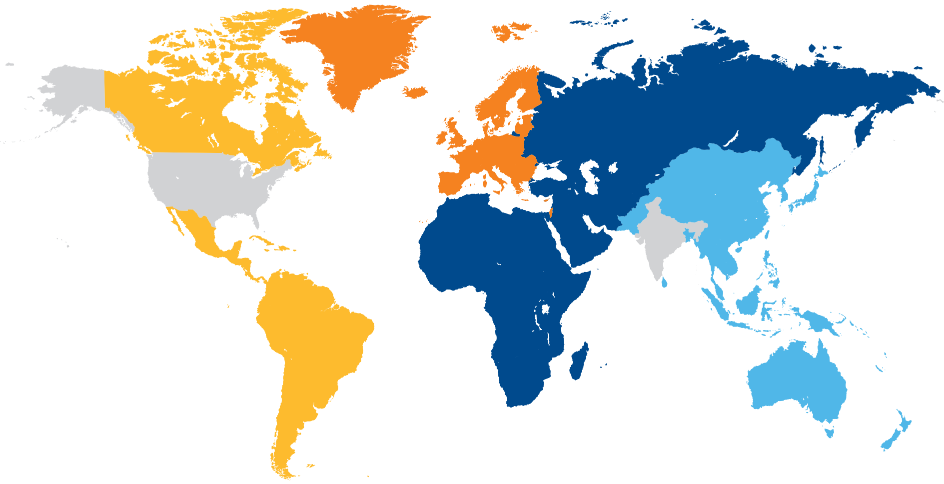
Strategic management

Our global performance

Adjusted profit from operations grew strongly at constant rates of exchange.

As reported profit can be materially affected by exchange rate movements, the regional performance is presented at constant rates of exchange.

Our five Global Drive Brands (GDBs) had another successful year in 2016, growing volume and share in Key Markets.



Americas

Share of Group revenue

21%

Volume

113bn

-8.8%
2015: 124bn

Revenue
at CC[1]

£3,014m

+10.8%
2015: £2,720m

Adjusted profit[2]

£1,172m

+0.3%
2015: £1,169m

Adjusted profit[2]
at CC[1]

£1,202m

+2.8%
2015: £1,169m

see page 18 to learn more

Western Europe

Share of Group revenue

25%

Volume

120bn

+6.7%
2015: 112bn

Revenue
at CC[1]

£3,471m

+8.4%
2015: £3,203m

Adjusted profit[2]

£1,389m

+21.2%
2015: £1,146m

Adjusted profit[2]
at CC[1]

£1,236m

+7.8%
2015: £1,146m

see page 18 to learn more

Eastern Europe, Middle East and Africa

Share of Group revenue

27%

Volume

236bn

+3.0%
2015: 229bn

Revenue
at CC[1]

£3,753m

+10.1%
2015: £3,408m

Adjusted profit[2]

£1,289m

+6.7%
2015: £1,208m

Adjusted profit[2]
at CC[1]

£1,271m

+5.3%
2015: £1,208m

see page 19 to learn more

Asia-Pacific

Share of Group revenue

27%

Volume

196bn

-0.9%
2015: 198bn

Revenue
at CC[1]

£3,770m

-0.1%
2015: £3,773m

Adjusted profit[2]

£1,630m

+11.0%
2015: £1,469m

Adjusted profit[2]
at CC[1]

£1,488m

+1.3%
2015: £1,469m

see page 19 to learn more

Notes:

1. Constant currency (CC) provides the information based on a re-translation, at prior year exchange rates, of the current year information.
2. Profit refers to adjusted profit from operations and is derived after excluding the adjusting items from the profit from operations. The main items for 2016/2015 are restructuring and integration costs, amortisation and impairment of trademarks and similar intangibles (see page 25).

Strategic management

Regional review

Americas

Adjusted profit, at current rates of exchange, was marginally ahead of prior year at £1,172 million as the reported results were impacted by the devaluation of the bolivar in Venezuela. At constant rates, adjusted profit rose by £33 million, or 2.8%, driven by good performances from Canada, Chile, Venezuela and Peru, more than offsetting lower profit in Brazil. Cigarette volume was down 8.8% to 113 billion, as higher volume in Mexico and Colombia was more than offset by declines in Brazil and Venezuela.

Performance at constant rates of exchange

Brazil

Lucky Strike grew market share, gaining segment leadership, with Dunhill growing within the premium segment. Total market share fell, from an all-time high. Lower consumer disposable income, higher VAT and excise-led price increases drove market contraction and higher illicit trade, adversely impacting volume and profit.

Canada

Strong profit growth was driven by good 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 profit. 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 profit. Pall Mall 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 led to stable profit.

Colombia

Higher volume, an improvement in market share and good pricing were more than offset by the adverse impact of foreign exchange on cost of sales, with profit down.

Argentina

Excise-led price increases drove a decrease in the total market and a decline in volume. Market share was marginally lower despite Rothman's growth following launch.

Western Europe

Adjusted profit, at current rates of exchange, grew by £243 million to £1,389 million reflecting the relative weakness in sterling against the reporting currencies, notably the euro. At constant rates, adjusted profit was higher by 7.8% (£90 million) or 6.9% on an organic basis, with good performances in several markets including Germany, Romania, Italy and France. Cigarette volume was up by 6.7% to 120 billion, or 2.4% on an organic basis, with growth in Poland and Romania more than offsetting lower volume in the UK, Denmark and Germany.

Performance at constant rates of exchange

Germany

Profit grew strongly driven by pricing, with volume marginally lower. Market share was flat as a good performance 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 over 7% category retail market share in 12 months.

Switzerland

Price discounting at retail led to down-trading in the market, lower volume, a fall in market share and a decline in profit.

France

Profit and volume were marginally higher. Market share was up, driven by the continued growth in Lucky Strike.

Romania

Profit grew very strongly driven by good pricing and higher volume. Excellent market share growth was driven by Pall Mall and Dunhill, more than offsetting a decline in Kent.

Italy

Higher volume and pricing drove profit up. Growth in Rothman's market share was more than offset by declines in the rest of the local portfolio with total market share down. Vype distribution was expanded. Vype Pebble was launched and the first flagship store was opened.

Denmark

Volume, market share and profit were down due to down-trading leading to the growth of the low-priced segment.

Netherlands

Profit 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

Profit 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 profit flat 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

Profit was marginally higher, driven by cost savings. Volume and market share were stable.

Poland

Market share grew strongly with volume higher due to the success of Pall Mall. The financial performance improved driven by the improved volume and pricing.

Croatia / Balkans

The integration of TDR is now substantially complete, with the migration to the GDB portfolio on track, driving an increase in total market share.

Eastern Europe, Middle East and Africa (EEMEA)

Adjusted profit, at current rates of exchange, increased by £81 million to £1,289 million. Good pricing across the region and strong profit growth in several markets was partly offset by the effect of currency devaluation, notably in Russia, Nigeria and Ukraine. At constant rates of exchange, profit would have increased by £63 million or 5.3%, or 4.3% on an organic basis. Excluding acquisitions and the impact of adverse foreign exchange movements on cost of sales, adjusted profit at constant rates would have increased by 19%. Cigarette volume was 3.0% higher at 236 billion (up 2.1% on an organic basis), as growth in a number of markets including Ukraine, Russia, Turkey and Algeria were partially offset by lower volume in South Africa and GCC.

Performance at constant rates of exchange

Russia

Profit was significantly higher, driven by good pricing and an increase in volume more than offsetting the continuing adverse impact of foreign exchange on cost of sales. Market share continued to grow strongly, driven by another excellent performance 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. Profit was down due to lower volume and the adverse transactional impact of foreign exchange on cost of sales, partially offset by pricing.

GCC

Profit was flat as pricing and cost savings offset 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 cost of sales, with profit in line with prior year.

Iran

Volume and profit were lower due to the retrospective application of an increase in excise.

Ukraine

Excellent 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 profit.

Turkey

Profit was up, driven by good pricing and higher volume. Market share grew as the excellent performance of Kent and Rothmans continued.

Egypt

An improvement in the financial performance was driven by higher volume, pricing and an enhanced mix.

Kazakhstan

Rothmans drove an increase in volume and market share. Profit improved as pricing and higher volume more than offset the effect of down-trading.

Algeria

Strong volume growth and pricing drove profit up.

Asia-Pacific

Adjusted profit, at current rates of exchange, was up by £161 million to £1,630 million as strong profit performances in Pakistan, Bangladesh, Sri Lanka, Vietnam and South Korea were partly offset by lower profit in Malaysia following a change in excise and the adverse impact of foreign exchange on cost of sales in a number of markets including Japan and New Zealand. At constant rates of exchange, adjusted profit grew £19 million or 1.3%. Cigarette volume fell 0.9% to 196 billion, as increases in Bangladesh, Vietnam, South Korea and Indonesia, were offset by industry declines in Pakistan and Malaysia.

Performance at constant rates of exchange

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 profit.

Malaysia

Volume and profit were down as the tax-driven price increases led to a reduction in the total market and higher illicit trade. Market share fell despite good 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 cost of sales led to a reduction in profit. glo, our Tobacco Heating Product, was launched in December 2016, with encouraging initial results.

New Zealand

Good pricing, an increase in market share and stable volume were more than offset by the adverse impact of foreign exchange on cost of sales, with profit marginally lower.

Bangladesh

Volume, market share and profit continued to increase strongly.

Pakistan

Profit increased significantly 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 the excise-led price increases.

Vietnam

Higher profit was driven by an increase in volume, pricing and an enhanced mix. Market share was stable as State Express 555 continued to perform well in the premium segment.

South Korea

Profit was up, driven by higher volume, including in Dunhill, and productivity initiatives. Market share fell despite good growth in Rothmans.

Indonesia

Volume and market share grew, driven by Dunhill and Lucky Strike, with the enhanced mix and strong pricing leading to an improvement in financial performance.

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 financial performance.

Financial Review

Financial performance summary

"An outstanding year of revenue, profit and earnings growth"

Ben Stevens
Finance Director

Highlights

- Group revenue – up 12.6% or 6.9% at constant rates of exchange
- Adjusted profit from operations at constant rates – higher by 4.1%
- Profit from operations up 2.2%
- Adjusted diluted earnings per share up 18.8% or 10.4% at constant rates
- Dividends for 2016 – up 10.0% at 169.4p per share
- Cash generated from operations at constant rates – down 13.4%, but up 21.3% excluding the impact of FII GLO receipt in 2015
- Operating cash flow conversion – 93%

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

	2016							2015		
	Reported £m	Adjusting items[1] £m	Adjusted £m	Impact of exchange £m	Adjusted at CC[2] £m	Impact of acquisitions £m	Adjusted organic[3] at CC[2] £m	Reported £m	Adjusting items £m	Adjusted £m
Revenue										
Asia-Pacific	4,266	–	4,266	(496)	3,770	–	3,770	3,773	–	3,773
Americas	2,868	–	2,868	146	3,014	–	3,014	2,720	–	2,720
Western Europe	3,867	–	3,867	(396)	3,471	(154)	3,317	3,203	–	3,203
EEMEA	3,750	–	3,750	3	3,753	(53)	3,700	3,408	–	3,408
Total region	14,751	–	14,751	(743)	14,008	(207)	13,801	13,104	–	13,104
Profit from operations										
Asia-Pacific	1,432	198	1,630	(142)	1,488	–	1,488	1,361	108	1,469
Americas	1,017	155	1,172	30	1,202	–	1,202	1,082	87	1,169
Western Europe	1,044	345	1,389	(153)	1,236	(11)	1,225	990	156	1,146
EEMEA	1,182	107	1,289	(18)	1,271	(12)	1,259	1,127	81	1,208
Total region	4,675	805	5,480	(283)	5,197	(23)	5,174	4,560	432	4,992
Non-tobacco litigation:										
Fox River/Flintkote[4]	(20)	20	–	–	–			(3)	3	–
Profit from operations	4,655	825	5,480	(283)	5,197			4,557	435	4,992
Net finance (costs)/income	(637)	108	(529)	35	(494)			62	(489)	(427)
Associates and joint ventures	2,227	(900)	1,327	(137)	1,190			1,236	(293)	943
Profit before tax	6,245	33	6,278	(385)	5,893			5,855	(347)	5,508
Taxation	(1,406)	(67)	(1,473)	47	(1,426)			(1,333)	(58)	(1,391)
Non-controlling interest	(191)	1	(190)	12	(178)			(232)	(3)	(235)
Profit attributable to shareholders	4,648	(33)	4,615	(326)	4,289			4,290	(408)	3,882
Diluted number of shares (m)	1,865		1,865		1,865			1,863		1,863
Diluted earnings per share (pence)	249.2		247.5		230.0			230.3		208.4

Notes
1. Adjusting items are items in the profit from operations that individually or, if of a similar type, in aggregate, are relevant to an understanding of the Group's underlying financial performance (see page 25).
2. 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 on page 25.
3. Organic excludes contribution by TDR, Sudan, Ten Motives and CHIC.
4. The Fox River and Flintkote 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.

Financial Review

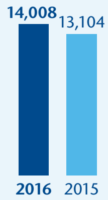
Income statement

Revenue

Revenue at constant rates of exchange (£m)

+7%
2016

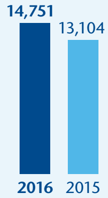
+5%
2015



Reported revenue (£m)

+13%
2016

-6%
2015



Reported revenue grew strongly, up 12.6% at £14,751 million, driven by good pricing in a number of key markets, and benefiting from the relative weakness of sterling. At constant rates of exchange, revenue grew by 6.9% or by 5.3% excluding the impact of acquisitions.

Profit from operations

Profit from operations grew 2.2%. Good price mix, productivity improvements and the impact of the weakness of sterling on our reported results were partly offset by the continued transactional foreign exchange headwinds. This negatively impacted the cost of hard currency denominated items such as leaf and wrapping materials in the operating currencies of our companies.

Adjusted profit from operations

To better evaluate the underlying performance of the business, management also reviews the results by adjusting for a number of items relating to restructuring and integration costs and one-off charges, provisions and income, being items the Group assesses as not relating to the day-to-day operations of the business (see page 25). During 2016, the Group incurred £603 million of restructuring and integration costs (2015: £367 million), being mainly in respect of the restructuring initiatives directly related to the implementation of the new operating model and factory rationalisations. Total adjusting items of £825 million (2015: £435 million) also included amortisation of goodwill on acquired trademarks and similar intangible assets of £149 million (2015: £65 million).

We call the underlying profit after these items 'adjusted profit from operations'. Adjusted profit from operations was £5,480 million, 9.8% higher than in 2015. Excluding the impact of translational foreign exchange tailwind noted above, adjusted operating profit, at constant rates of exchange, would have increased by 4.1% or by 3.6% on an organic basis.

Operating margin

Operating margin (%)

-90 bps
2016

-60 bps
2015

In 2016, operating margin, defined as adjusted profit from operations as a percentage of net revenue, fell by 90 bps. Excluding the transactional foreign exchange headwind and the impact from acquisitions, underlying operating margin would have grown by around 160 bps.

Net finance (costs)/income

Net finance costs were £637 million (2015: £62 million income) and included one-off costs of £101 million related to the early settlement of a bond as described on page 23, interest of £25 million (2015: £8 million) related to FII GLO and a £18 million hedge ineffectiveness gain, arising following the market volatility due to Brexit, and which does not reflect the normal course of business. 2015 also benefited from a deemed gain (£601 million) related to the Group's investment in Reynolds American. After adjusting for these items, net adjusted finance costs were £529 million, £101 million higher than 2015 reflecting the increased level of borrowing, with the Group's average cost of debt in line with prior year.

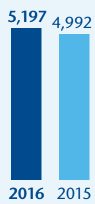
Adjusted profit from operations by region at constant rates of exchange (£bn)

	2016
Western Europe	1.2
EEMEA	1.3
Asia-Pacific	1.5
Americas	1.2

Adjusted profit from operations at constant rates of exchange

4%
2016

4%
2015



Percentage changes in revenue and in profit from operations (%)

	2016		2015	
	Revenue growth	**Profit growth**	Revenue growth	Profit growth
As reported	**+12.6**	**+2.8**	-6.2	+0.2
Adjusted		**+9.8**		-7.6
Adjusted at constant rates	**+6.9**	**+4.1**	+5.4	+4.0
Adjusted excluding all currency (est.)		**+10.0**		+10.0

Financial Review

Income statement continued

Associates

The Group's share of the post-tax results of associates, included at the pre-tax profit level under IFRS, grew by £991 million to £2,227 million. When net adjusting income of £900 million, largely related to the sale by Reynolds American of the international rights to Natural American Spirit (£293 million net gains in 2015 largely related to the Group's share of the gain earned on the divestiture of brands by Reynolds American to ITG Brands) are excluded, the Group's share of the adjusted post-tax results of associates increased by 41% to £1,327 million. This was primarily driven by Reynolds American, whose adjusted contribution increased by 52% to £991 million, or by 35% at constant rates of exchange. The adjusted contribution from ITC Ltd (the Group's associate in India) grew by 15%, or 7% at constant rates of exchange.

Tax

Underlying tax rate
(%)

29.8%

The tax rates in the Income Statement of 22.5% in 2016 and 22.8% in 2015 are affected by the inclusion of adjusting items and the associates' post-tax profit in the Group's pre-tax results. Excluding these, the underlying tax rate for subsidiaries was 29.8% in 2016 and 30.5% in 2015.

The Group's global tax strategy is reviewed regularly by the Board. The operation of the strategy is managed by the Finance Director and Group Head of Corporate Tax with the Group's tax position reported to the Audit Committee on a regular basis. The Board considers tax risks that may arise as a result of our business operations.

In summary, the strategy includes:

– compliance with all applicable laws and regulations in countries in which we operate;
– be open and transparent with tax authorities and operate to build mature professional relationships;
– support the business strategy of the Group by undertaking efficient management of our tax affairs in line with the Group's commercial activity;
– transact on an arm's length basis for exchanges of goods and services between companies within the Group; and
– engage in proactive discussions with tax authorities on occasions of differing legal interpretation. Where resolution is not possible, tax disputes may proceed to litigation.

The Group seeks to establish strong tax technical positions. Where legislative uncertainty exists, resulting in differing interpretations, the Group seeks to establish that its position would be more likely than not to prevail. Transactions between Group subsidiaries are conducted on arm's length terms in accordance with appropriate transfer pricing rules and OECD principles.

The corporate tax charge for 2016 was £1.4 billion (2015: £1.3 billion), with tax paid (due to the timing of corporation tax instalment payments which straddle different financial years) of £1.2 billion (2015: £1.3 billion).

Our tax footprint extends beyond corporation tax, including significant payment of employment taxes and other indirect taxes including customs and import duties. The Group also collects taxes on behalf of governments (including tobacco excise, employee taxes, VAT and other sales taxes). The total tax contribution (2016: £33.2 billion, 2015: £29.6 billion) therefore consists of both taxes borne and taxes collected as shown in the table below.

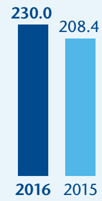
In addition to the major taxes, there are a host of other taxes the Group bears and collects such as transport taxes, energy and environmental taxes, and banking and insurance taxes.

Earnings per share

Adjusted diluted EPS at constant rates of exchange
(pence)

+10%
2016

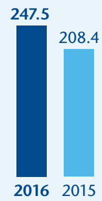
+10%
2015



Adjusted diluted EPS
(pence)

19%
2016

0%
2015



Basic earnings per share were 8.4% higher at 250.2p (2015: 230.9p), benefiting from the growth in the Group's operating performance and the foreign exchange tailwind on translation of the Group results. This is subject to the dilutive effect of employee share schemes, with diluted basic earnings per share at 249.2p (2015: 230.3p).

The above are impacted by the adjusting items discussed earlier. As such, earnings per share are best viewed on the basis of adjusted diluted earnings per share – with the calculation provided in note 7 on the Financial Statements.

On this basis, adjusted diluted EPS was ahead of prior year by 18.8% at 247.5p. When the translational impact of exchange rate movements on our reported results are excluded, adjusted diluted EPS at constant rates would have been 10.4% ahead of 2015 at 230.0p.

Major taxes paid

	2016 £bn	2015 £bn
Tobacco excise (collected)	**25.9**	22.7
Net VAT and other sales taxes (collected)	**5.2**	4.8
Corporation tax (borne)	**1.2**	1.3
Customs and import duties (borne)	**0.4**	0.3
Taxes paid by employee (collected)	**0.3**	0.3
Employment taxes (borne)	**0.2**	0.2
	33.2	29.6

Shareholder returns and capital effectiveness

Dividends

The Group's policy is to pay dividends of 65% of long-term sustainable earnings, calculated with reference to the adjusted diluted earnings per share. However, despite adverse exchange rate movements, where possible we like to reward shareholders with an increase in the dividends in sterling terms. Interim dividends are calculated as one-third of the total dividends declared for the previous year.

With the recommended final dividend of 118.1p, the total dividends per share for 2016 are 169.4p, compared to the total dividend of 154.0p for 2015. This leads to a total dividend growth of 10% and a pay-out ratio of 68.4%.

Under IFRS, the recommended final dividend in respect of a year is only provided in the accounts of the following year. Therefore, the 2016 accounts reflect the 2015 final dividend and the 2016 interim dividend amounting to 155.9p (£2,910 million in total (2015: 150.0p – £2,770 million)).

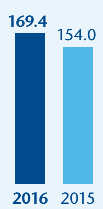
The table below shows the dividends declared in respect of 2016 and 2015.

Dividends are declared/proposed and payable in sterling except for those shareholders on the branch register in South Africa, whose dividends are payable in rand. A rate of exchange of £:R=16.32100 as at 21 February 2017, the closing rate for that day as quoted by Bloomberg, results in an equivalent final dividend of 1,927.51010 SA cents per ordinary share. Further details of the final dividend and key dates (and the South Africa branch register key dates) are set out in the other corporate disclosures section on page 77.

Dividends per share declared
(pence)

+10%
2016

+4%
2015



Treasury, liquidity and capital structure

The Treasury function is responsible for raising finance for the Group, managing the Group's cash resources and managing the financial risks arising from underlying operations. Clear parameters have been established, including levels of authority, on the type and use of financial instruments to manage the financial risks facing the Group. Such instruments are only used if they relate to an underlying exposure; speculative transactions are expressly forbidden under the Group's treasury policy. All these activities are carried out under defined policies, procedures and limits, reviewed and approved by the Board, delegating oversight to the Finance Director and Treasury function.

It is the policy of the Group to maximise financial flexibility and minimise refinancing risk by issuing debt with a range of maturities, generally matching the projected cash flows of the Group and obtaining this financing from a wide range of providers. The Group targets an average centrally managed debt maturity of at least five years with no more than 20% of centrally managed debt maturing in a 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 12-month period was 18.1% (2015: 15.0%).

It is Group policy that short-term sources of funds (including drawings under both the US$3 billion US commercial paper programme and the £1 billion euro commercial paper programme) are backed by undrawn committed lines of credit and cash. At 31 December 2016, £254 million of commercial paper was outstanding (2015: £505 million).

In March 2016, a one-year extension option was exercised for the £3 billion main bank facility, extending the final maturity to May 2021. The facility was undrawn as at 31 December 2016.

In March 2016, a US$300 million bond was repaid. In July 2016, the Group issued a £500 million bond maturing in 2021, with two bonds issued in September 2016 (a US$650 million bond maturing in 2019 and a £650 million bond maturing in 2052). The Group repaid on maturity of a CHF 350 million bond in August 2016 and a £325 million bond in September 2016.

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, manage future refinancing risk and reduce the on-going interest expense.

In January 2017, following the announcement that the Group agreed the terms in relation to the proposed acquisition of the shares not already in Reynolds American, a US$25 billion acquisition facility was entered into with a syndicate of banks, split in four tranches as follows: two bridge facilities of US$15 billion and US$5 billion maturing in 2018 and 2019 respectively (each with two six-month extensions at the Group'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 markets.

The Group increased its liquidity position with a new two-tranche £5.7 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. This will effectively replace the Group's existing £3 billion revolving credit facility, which will be cancelled upon closing of the acquisition when the new revolving credit facility will become effective.

The Group continues to maintain investment-grade credit ratings, with ratings from Moody's/S&P at Baa2 (stable outlook)/BBB+ (stable outlook) respectively immediately following the above facility agreements. The strength of the ratings has underpinned debt issuance and the Group is confident of its ability to successfully access the debt capital markets. All contractual borrowing covenants have been met and none are expected to inhibit the Group's operations or funding plans.

The Group defines capital as net debt and equity. The only externally imposed capital requirement the Group has is in respect of its centrally managed banking facilities, which require a gross interest cover of 4.5 times. The Group targets a gross interest cover, as calculated under its key central banking facilities, of greater than 5. For 2016, it is 12.2 times (2015: 11.6 times).

Return on capital employed

The Group's return on capital employed (ROCE) was 32% (2015: 33%), due to the impact of exchange rates on the Group's net asset position. ROCE is the adjusted profit from operations, divided by the average total assets (less investment in associates and joint ventures) net of average current liabilities.

Dividends declared/proposed

	2016		2015	
Ordinary shares	**Pence per share**	**£m**	Pence per share	£m
Interim	**51.3**	**961**	49.4	908
Final	**118.1**	**2,194**	104.6	1,943
	169.4	**3,155**	154.0	2,851

Financial Review

Cash flow

Alternative cash flow

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

Operating cash flow increased by £539 million, or 11.8%, to £5,122 million, reflecting the excellent growth in underlying operating performance of the Group which was partly offset by higher capital expenditure, including that for Next Generation Products. Free cash flow was lower by £92 million or 2.6%, at £3,389 million as the improved operating performance, higher distributions from associates (including the proceeds from Reynolds American's share buy-back programme) and lower payments to minorities following the buy-out of Souza Cruz were more than offset by the FII GLO receipt in 2015, which does not repeat and the increase in Quebec Class Action-related cash deposits.

The conversion of adjusted profit from operations to operating cash flow remained strong at 93% (2015: 92%). The ratio of free cash flow per share to adjusted diluted earnings per share fell to 73% from 90% in 2015 as the prior year benefited from the receipt in relation to FII GLO.

Below free cash flow, the principal cash outflows for 2016 comprise the payment of the prior year final dividend and the 2016 interim dividend as well as net investment activities which included the acquisition of Ten Motives. During 2015, the cash outflow from net investing activities was £5,192 million relating to the investment in Reynolds American, the buy-out of the minorities in Souza Cruz and the acquisition of TDR in Croatia.

Net debt

After taking account of other changes, especially exchange rate movements, total net debt, defined as borrowings, including related derivatives, less cash and cash equivalents and current available-for-sale, was £1,973 million higher at £16,767 million at 31 December 2016 (2015: £14,794 million).

Cash generated from operations at constant rates (excl. FII GLO) (£m)

£2,918m

+21.3%

* 2015 excl. FII GLO inflow

Cash flow and net debt movements (at current rates, unless specifically stated)

	2016 £m	2015 £m
Adjusted profit from operations	5,480	4,992
Depreciation, amortisation and impairment	393	338
Other non-cash items in operating profit	62	(1)
Profit from operations before depreciation and impairment	5,935	5,329
Increase in working capital	(254)	(263)
Net capital expenditure	(559)	(483)
Gross capital expenditure	(652)	(591)
Sale of fixed assets	93	108
Operating cash flow	5,122	4,583
Pension funds' shortfall funding	(78)	(148)
Net interest paid	(537)	(522)
Tax paid	(1,245)	(1,273)
Franked Investment Income Group Litigation Order (FII GLO)	–	963
Dividends paid to non-controlling interests	(147)	(235)
Cash generated from operations	3,115	3,368
Restructuring costs	(452)	(405)
Non-tobacco litigation: Flintkote and Fox River (settlement)	(17)	(20)
Tobacco litigation: Quebec (deposit)	(242)	(55)
Dividends and other appropriations from associates	985	593
Free cash flow	3,389	3,481
Dividends paid to shareholders	(2,910)	(2,770)
Net investment activities	(166)	(5,192)
Net flow from net investment hedges, share schemes and other	(476)	(52)
Net cash outflow	(163)	(4,533)
Note – Cash generated from operations at constant rates of exchange	2,918	3,368
Movements on net debt		
Exchange rate effects*	(1,684)	(112)
Change in accrued interest and other	(126)	16
Change in net debt	(1,973)	(4,629)
Opening net debt	(14,794)	(10,165)
Closing net debt	(16,767)	(14,794)

* Including movements in respect of debt-related derivatives.

Net debt

	2016 £m	2015 £m
Net debt due within one year		
Borrowings	(3,007)	(2,195)
Related derivatives	498	46
Cash and cash equivalents	2,204	1,963
Current available-for-sale investments	15	35
	(290)	(151)
Net debt due beyond one year		
Borrowings	(16,488)	(14,806)
Related derivatives	11	163
	(16,477)	(14,643)
Total net debt	(16,767)	(14,794)

Operating cash flow conversion ratio

	2016	2015
Operating cash flow conversion	93%	92%

Financial Review

Other

Retirement benefit schemes

The Group's subsidiaries operate around 170 retirement benefit arrangements worldwide. The majority of the scheme members belong to defined benefit schemes, most of which are funded externally and many are closed to new entrants. The Group also operates a number of defined contribution schemes.

The present total value of funded scheme liabilities as at 31 December 2016 was £7,155 million (2015: £5,956 million), while unfunded scheme liabilities amounted to £476 million (2015: £364 million). The schemes' assets increased from £6,086 million in 2015 to £7,278 million in 2016. After excluding unrecognised scheme surpluses of £18 million (2015: £11 million), the overall net liability for all pension and health care schemes in Group subsidiaries amounted to £371 million at the end of 2016, compared to £245 million at the end of 2015.

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

Non-GAAP measures

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

The principal non-GAAP measures that the Group uses are adjusted profit from operations and adjusted diluted earnings per share, which are reconciled to profit from operations and diluted earnings per share. These measures remove the impact of adjusting items from earnings. Adjusting items are those that individually or, if similar in nature, in aggregate, are relevant to an understanding of the Group's underlying financial performance.

The Management Board, as the chief operating decision maker, reviews current and prior year segmental revenue and 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, the Group also gives a figure for growth in adjusted operating profit excluding both transactional and translational foreign exchange movements.

As an additional measure to indicate the impact of exchange rate movements on the Group results, adjusted diluted earnings per share is also shown at constant translation rates of exchange.

The Group includes organic measures of volume, revenue and adjusted profit from operations to ensure a full understanding of the underlying operating performance of the Group, before the impact of acquisitions.

The Group also prepares an alternative cash flow, which includes a measure of 'free cash flow' to illustrate the cash flows before transactions relating to borrowings. A net debt summary is also provided. The Group publishes gross turnover as an additional disclosure to indicate the impact of duty, excise and other taxes. Due to the secondary listing of the ordinary shares of British American Tobacco p.l.c. on the JSE Limited (JSE) in South Africa, the Group is required to present headline earnings per share and headline diluted earnings per share.

Accounting policies

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

Accounting developments

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

There were no material changes to the accounting standards applied in 2016 from that applied in 2015.

Future changes applicable on the accounting standards that will be applied by the Group are set out in the Notes on the Accounts (note 1 – Accounting Policies). However, the impact is not expected to be material to the Group's results.

Going concern

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

The key Group risk factors include analyses of financial risk and the Group's approach to financial risk management. Notes 20 and 23 in the Notes on the Accounts provide further detail on the Group's borrowings and management of financial risks.

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

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

Foreign exchange rates

	Average		Closing	
	2016	2015	**2016**	2015
Australian dollar	**1.824**	2.036	**1.707**	2.026
Brazilian real	**4.740**	5.101	**4.022**	5.831
Canadian dollar	**1.795**	1.954	**1.657**	2.047
Euro	**1.224**	1.378	**1.172**	1.357
Indian rupee	**91.022**	98.070	**83.864**	97.508
Japanese yen	**147.466**	185.012	**144.120**	177.303
Russian rouble	**91.026**	93.591	**75.429**	107.646
South African rand	**19.962**	19.522	**16.898**	22.839
US dollar	**1.355**	1.528	**1.236**	1.474

Business environment

Principal Group risk factors

Overview

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

Each risk is considered in the context of the Group's strategy, as set out in this Strategic Report on page 6. Following a description of each risk, its potential impact and mitigation for the Group is summarised. Clear accountability is attached to each risk through the risk owner.

The Group has identified and is actively monitoring and taking action to mitigate the risks. This section focuses on those risks that the Directors believe to be the most important after assessment of the likelihood and potential impact on the business. Not all of these risks are within the control of the Group and other factors besides those listed may affect the Group's performance. Some risks may be unknown at present. Other risks, currently regarded as less material, could become material in the future.

The risk factors listed in this section and the activities being undertaken to mitigate them should be considered in the context of the Group's internal control framework. This is described in the section on risk management and internal control in the corporate governance statement on page 44. This section should also be read in the context of the cautionary statement set out below.

Assessment of Group risk

During the year, the Directors have carried out a robust assessment of the principal risks and uncertainties facing the Group, including those that would threaten its business model, future performance, solvency or liquidity.

The principal risks facing the Group have remained broadly unchanged over the past year, particularly with regard to the principal risks included in Marketplace, Excise and Tax, Operations, Regulation and Litigation risk factors. The Board has considered the risks associated with the inability to recruit required talent and the loss of existing talent. The impact and likelihood of the risk has decreased and it is no longer a principal risk.

The viability statement below provides a broader assessment of long-term solvency and liquidity, the statement being forward-looking. The Directors have considered a number of factors that may affect the resilience of the Group, including some of the principal risks that may impact the Group's viability. This is indicated in the 'impact on viability statement' key under each risk.

Key

Time frame

- Short term
- Medium term
- Long term

Strategic impact

- Growth
- Productivity
- Winning Organisation
- Sustainability

Considered in viability statement

- Yes ✓
- No ✕

Cautionary statement

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

Viability Statement

The Directors have assessed the viability of the Group, in accordance with provision C.2.2 of the 2016 revision of the UK Corporate Governance Code. In making this assessment the Directors have considered the Group's continued strong cash generation from operating activities and the impact of the proposal to acquire the shares in Reynolds American not already owned by the Group, as this will increase the Group's net debt. This assessment included a robust review of the principal risks that may impact the Group's viability (as indicated on pages 27–30) which are considered, with the mitigating actions, at least once a year. The Directors also took account of the Group's operational and financial processes, which cover both short term (1-2 year financial forecasts, 2-3 year capacity plans) and longer term strategic planning. The assessment included reverse stress testing core drivers that underpin the specific risks to ensure the business is able to continue in operation, whilst not breaching the required gross interest cover of 4.5 times (see page 23). Each impact would, individually, have to be between 5x and 17x worse than a prudent annual forecast. If all risks arose simultaneously the Group would continue to be able to meet the liabilities as they fall due.

The Directors noted that the Group would be able to adjust certain capital requirements, including but not limited to the investment in the Group's manufacturing infrastructure in the short term and the £3 billion credit facility (2016: undrawn), to mitigate the impact of the effect of the above principal risks, each of which have specific mitigation activities as disclosed on pages 27–30.

The Group operates in a unique environment, being subject to inherent uncertainties with regards to regulatory change and litigation, the outcome of which may have a bearing on the Group's viability. The Group maintains, as referred to in note 28 "Contingent Liabilities and Financial Commitments", that, whilst it is impossible to be certain of the outcome of any particular case, the defences of the Group's companies to all the various claims are meritorious on both law and the facts. If an adverse judgment is entered against any of the Group's companies in any case, an appeal will be made, the duration of which can be reasonably expected to last for a number of years.

The Directors have no reason to believe the Group will not be viable over a longer period. However, given the inherent uncertainty involved regarding litigation and regulation, the period over which the Directors consider it possible to form a reasonable expectation as to the Group's longer term viability, based on the stress testing and scenario planning discussed above, is three years.

Risks

Competition from illicit trade

Increased competition from illicit trade – either local duty evaded, smuggled illicit white cigarettes or counterfeits.

Time frame	Strategic impact	Considered in viability statement
Long term	Growth	Yes

Impact

Erosion of brand value, with lower volumes and reduced profits.

Reduced ability to take price increases.

Investment in trade marketing and distribution is undermined.

Mitigation activities

Dedicated Anti-Illicit Trade (AIT) teams operating at global, country levels and internal cross-functional coordination; best practice shared.

Active engagement with key external stakeholders.

Cross-industry and multi-sector cooperation on a range of AIT issues.

Global AIT strategy supported by a research programme to further the understanding of the size and scope of the problem.

AIT Engagement Team (including a dedicated analytical laboratory) works with enforcement agencies in pursuit of priority targets.

Tobacco regulation inhibits growth strategy

The enactment of unreasonable regulation that prohibits the Group's ability to communicate with consumers, differentiate our products and launch future products.

Time frame	Strategic impact	Considered in viability statement
Medium term	Growth and Sustainability	Yes

Impact

Erosion of brand value through commoditisation, the inability to launch innovations, differentiate products, maintain or build brand equity and leverage price.

Adverse impact on ability to compete within the legitimate tobacco industry and also with increased illicit trade.

Reduced consumer acceptability of new product specifications, leading to consumers seeking alternatives in illicit trade.

Shocks to share price on enactment of unduly onerous and restrictive regulation.

Reduced ability to compete in future product categories and make new market entries.

Increased scope and severity of compliance regimes in new regulation leading to higher costs, greater complexity and potential reputational damage or fines for inadvertent breach.

Mitigation activities

Engagement and litigation strategy coordinated and aligned across the Group to drive a balanced global policy framework for tobacco control.

Stakeholder mapping and prioritisation, developing robust compelling advocacy materials (with supporting evidence and data) and regulatory engagement programmes.

Regulatory risk assessment of marketing plans to ensure decisions are informed by an understanding of the potential regulatory environments.

Advocating the application of our integrated regulatory proposals to governments and public health practitioners based on the harm reduction principles.

Development of an integrated regulatory strategy that spans conventional combustibles and includes Next Generation Products.

Significant excise increases or structure changes

The Group is exposed to unexpected and/or significant excise increases or structure changes in key markets.

Time frame	Strategic impact	Considered in viability statement
Long term	Growth	Yes

Impact

Consumers reject the Group's legitimate tax-paid products for products from illicit sources or cheaper alternatives.

Reduced legal industry volumes.

Reduced sales volume and/or portfolio erosion.

Some absorption of excise increases.

Mitigation activities

Requirement for Group companies to have in place formal pricing and excise strategies including contingency plans, with annual risk assessments.

Pricing, excise and trade margin committees in markets, with regional and global support.

Engagement with local tax and customs authorities, where appropriate, in particular in relation to the increased risk to excise revenues from higher illicit trade.

Portfolio reviews to ensure appropriate balance and coverage across price segments.

Monitoring of economic indicators, government revenues and the political situation.

Principal Group risk factors continued

Risks continued

Litigation

Product liability, regulatory or other significant cases may be lost or compromised resulting in a material loss or other consequence. Legal costs may increase significantly.

Time frame	Strategic impact	Considered in viability statement
Long term	Growth	Yes

Impact

Damages and fines, negative impact on reputation, disruption and loss of focus on the business.

Consolidated results of operations, cash flows and financial position could be materially affected, in a particular fiscal quarter or fiscal year, by an unfavourable outcome or settlement of pending or future litigation.

Mitigation activities

Consistent litigation strategy across the Group.

Expertise and legal talent maintained both within the Group and with our external partners.

Closer integration in Group litigation strategy and cost controls pursued.

Ongoing monitoring of key legislative, case law and tobacco developments.

Geopolitical tensions

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

Time frame	Strategic impact	Considered in viability statement
Medium term	Growth	Yes

Impact

Potential loss of life, loss of assets and disruption to normal business processes.

Increased costs due to more complex supply chain arrangements and/or the cost of building new facilities or maintaining inefficient facilities.

Mitigation activities

Globally integrated sourcing strategy and contingency sourcing arrangements.

Security risk modelling, including external risk assessments and the monitoring of geopolitical and economic policy developments worldwide.

Insurance cover and business continuity planning, including scenario planning and testing, and risk awareness training.

Security controls for field force, direct store sales and supply chain with an emphasis on the protection of Group employees.

Inability to obtain price increases and impact of increases on consumer affordability thresholds

Annual manufacturers' price increases are among the key drivers in increasing market profitability. The Group faces a risk that such price increases will not materialise.

Time frame	Strategic impact	Considered in viability statement
Short/Medium term	Growth	Yes

Impact

Inability to achieve strategic growth metrics.

Funds to invest in growth opportunities are reduced.

Volumes may reduce faster than anticipated due to accelerated market decline leading to growth of illicit trade.

Mitigation activities

Key market pricing reviews at Management Board meetings.

Pricing strategies, excise and trade margin committees exist in all markets with regional and global support.

Robust business cases underpinning key innovative launches.

Clear portfolio and pricing strategies, ensuring a balanced portfolio of strong brands across key segments.

Disputed taxes, interest and penalties

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

Time frame	Strategic impact	Considered in viability statement
Short/Medium term	Productivity	Yes

Impact

Significant fines and potential legal penalties.

Disruption and loss of focus on the business due to diversion of management time.

Impact on profit and dividend.

Mitigation activities

End-market tax committees.

Internal tax function provides dedicated advice and guidance, and external advice sought where needed.

Engagement with tax authorities at Group, regional and individual market level.

Market size reduction and consumer down-trading

The Group is faced with steep excise-led price increases and the continuing difficult economic and regulatory environment in many countries, market contraction and consumer down-trading is a risk.

Time frame	Strategic impact	Considered in viability statement
Short/Medium term	Growth	Yes

Impact

Volume decline and portfolio mix erosion.

Funds to invest in growth opportunities are reduced.

Mitigation activities

Geographic spread mitigates impact at Group level.

Clear monitoring of portfolio and pricing strategies, ensuring balanced portfolio of strong brands across key segments.

Increased focus behind product quality and innovation across all segments to provide tangible differentiation and improve the price–value ratio.

Overlap with many mitigation activities undertaken for other principal risks facing the Group, such as competition from illicit tobacco trade, significant excise increases or structure changes and inability to obtain price increases.

Foreign exchange rate exposures

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

Time frame	Strategic impact	Considered in viability statement
Short/Medium term	Productivity	Yes

Impact

Fluctuations in FX rates of key currencies against sterling introduce volatility in reported EPS, cash flow and the balance sheet driven by translation into sterling of our financial results.

The dividend may be impacted if the payout ratio is not adjusted.

Differences in translation between earnings and net debt may affect key ratios used by credit rating agencies.

Volatility and/or increased costs in our business, due to transactional FX, may adversely impact financial performance.

Mitigation activities

While translational FX exposure is not hedged, its impact is identified in results presentations and financial disclosures; earnings are re-stated at constant rates for comparability.

Debt and interest are matched to assets and cash flows to mitigate volatility where possible and economic to do so.

Hedging strategy for transactional FX and framework is defined in the treasury policy, a global policy approved by the Board.

Illiquid currencies of many markets where hedging is either not possible or uneconomic are reviewed on a regular basis.

Business environment

Principal Group risk factors continued

Risks continued

Injury, illness or death in the workplace

The risk of injury, death or ill health to employees and those who work with the business is a fundamental concern of the Group and can have a significant effect on its operations.

Time frame	Strategic impact	Considered in viability statement
Short term	Sustainability	No

Impact

Serious injuries, ill health, disability or loss of life suffered by employees and the people who work with the Group.

Exposure to civil and criminal liability and the risk of prosecution from enforcement bodies and the cost of associated fines and/or penalties.

Interruption of Group operations if issues are not addressed immediately.

High staff turnover or difficulty recruiting employees if perceived to have a poor Environment, Health and Safety (EHS) record.

Mitigation activities

Risk control systems in place to ensure equipment and infrastructure are provided and maintained.

An EHS strategy ensures that employees at all levels receive appropriate EHS training and information.

Behavioural-based safety programme to drive Operations' safety performance and culture closer to zero accidents.

Analysis of incidents undertaken regionally and globally by a dedicated team to identify increasing incident trends or high potential risks that require coordinated action.

Solvency and liquidity

Liquidity (access to cash and sources of finance) is essential to maintaining the Group as a going concern in the short term (liquidity) and medium term (solvency).

Time frame	Strategic impact	Considered in viability statement
Short/Medium term	Productivity	Yes

Impact

Inability to fund the business under our current capital structure resulting in missed strategic opportunities or inability to respond to threats.

Decline in our creditworthiness and increased funding costs for the Group.

Requirement to issue equity or seek new sources of capital.

Reputational risk of failure to manage the financial risk profile of the business, resulting in an erosion of shareholder value reflected in an underperforming share price.

Mitigation activities

Group policies include a set of financing principles and key performance indicators including the monitoring of credit ratings, interest cover, solvency and liquidity with regular reporting to the Board.

The Group targets an average centrally managed debt maturity of at least five years with no more than 20% of centrally managed debt maturing in a single rolling year.

The Group, through B.A.T. International Finance p.l.c., holds a central banking facility of £3 billion with a final maturity of May 2021 spread across a wide banking group.

Liquidity pooling structures are in place to ensure that there is maximum mobilisation of cash liquidity within the Group.

The Group has an externally imposed capital requirement for its centrally managed banking facilities of maintaining gross interest cover above 4.5 times. The Group targets a gross interest cover of greater than 5.

Going concern and viability support papers are presented to the Board on a regular basis.

Directors' Report

Chairmans introduction

Richard Burrows
Chairman

Index to key elements

Dear Shareholder

We were delighted that BAT was ranked first out of all FTSE 100 companies for corporate governance in the Institute of Directors' 2016 Good Governance Report. I believe that the result reflects the focus that the Board and management give to corporate governance and the openness, transparency and clarity of objectives which we all work hard to achieve.

In 2016, our Remuneration Committee continued its work on revising our remuneration structure. We consulted with our shareholders and this resulted in our revised Remuneration Policy receiving a 90% vote of approval at our AGM in April 2016. You will find details of our new policy in the Remuneration Committee report on page 49.

All our employees are required to understand and abide by our Standards of Business Conduct. We will not tolerate improper conduct in our business anywhere in the world and take any allegations of misconduct extremely seriously. We are investigating, through external legal advisers, allegations of misconduct and are liaising with the Serious Fraud Office and other relevant authorities.

This year we began a project to review and further strengthen all aspects of the Group's global compliance procedures and ensure that our Standards of Business Conduct procedures remain robust. This important project will continue into 2017 and will create an integrated centre of excellence to champion and guide the Group's Standards of Business Conduct programme.

We have implemented key EU legislative corporate governance changes this year. Our Audit Committee revised our Auditor Independence Policy as required by the EU Audit Directive and Regulation which came into force in June 2016. The Board also carried out a full review of our share dealing and inside information procedures as required by the Market Abuse Regulation which came into force in July 2016.

We rigorously evaluate our own performance on an annual basis. Our evaluation this year was externally facilitated by Independent Audit Limited. They found that our Board functions very well and each of the Board committees is efficient and effective. You will find the key outcomes from this year's evaluation in this section on pages 40–41, including our proposed actions for 2017.

We also review our ways of working on a regular basis and this year have refreshed our committee structure and composition. We aligned Corporate and Social Responsibility matters with our regional corporate governance framework by making these a focus of our Board and Audit Committee. From 1 January 2017, meetings of the Audit and Remuneration Committees will be held simultaneously, which will provide more time for in-depth discussions at Board meetings.

A successful completion of our proposed acquisition of Reynolds American will add additional governance complexity, including Sarbanes-Oxley compliance requirements. The Board remains committed to ensuring that its governance processes continue to meet the toughest of global standards and that the Board itself has the capability and diversity to respond to an evolving corporate governance landscape.

On behalf of the Board I confirm that we believe that this Annual Report presents a fair, balanced and understandable assessment of the Company's position, its performance and its prospects as well as its business model and strategy.

Richard Burrows
Chairman

Compliance statement

Throughout the year ended 31 December 2016 and to the date of this document, we applied the Main Principles of the April 2016 version of the UK Corporate Governance Code (the Code) as it applies to the year ended 31 December 2016. The Company was compliant with all provisions.

The Board considers that this Annual Report, and notably this section, provides the information shareholders need to evaluate how we have complied with our current obligations under the Code.

For ease of reference, we prepare a separate annual compliance report by reference to each provision of the Code. This report is available at www.bat.com/governance.

We comply with the Disclosure Guidance and Transparency Rules requirements for corporate governance statements by virtue of the information included in this section, together with the information contained in the 'Other corporate disclosures' section.

Directors' Report

Board of Directors

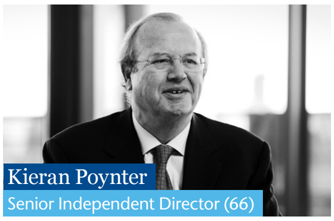
Richard Burrows
Chairman (71)

Nationality: Irish

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

Other appointments: Chairman of the Board and Chair of the Nomination, Remuneration and Compliance Committees of Craven House Capital plc; NED of Rentokil Initial plc; Supervisory Board member and Chairman of the Remuneration Committee at Carlsberg A/S.

Skills and experience: Richard brings considerable consumer goods and international business experience to the Board, having been Chief Executive of Irish Distillers and Co-Chief Executive of Pernod Ricard. Prior to joining the Board, Richard was Governor of the Bank of Ireland. Richard is a Fellow of the Institute of Chartered Accountants of Ireland.



Kieran Poynter
Senior Independent Director (66)

Nationality: British

Position: Senior Independent Director since 26 October 2016; Non-Executive Director since 2010; Chairman of the Audit Committee since 1 October 2016 and member of the Nominations Committee.

Other appointments: NED and Chair of the Audit and Compliance Committee of International Consolidated Airlines Group S.A.; Chairman and Chair of the Nominations, Audit and Compliance and Risk and Remuneration Committees of F&C Asset Management plc.

Skills and experience: Kieran brings a wealth of financial and international experience to the Board. He was Chairman and Senior Partner of PricewaterhouseCoopers from 2000 to his retirement in 2008, having started as a graduate trainee in 1971; and is a former Chairman of Nomura International PLC. Kieran served on the President's Committee of the Confederation of British Industry and as member of an advisory committee for the Chancellor of the Exchequer. Kieran is a Chartered Accountant.

Nicandro Durante
Chief Executive (60)

Nationality: Brazilian/Italian

Position: Chief Executive since 2011.

Other appointments: Non-Executive Director of Reckitt Benckiser Group plc.

Skills and experience: Nicandro has extensive leadership skills developed in various senior international roles within the Group. He joined Souza Cruz in Brazil in 1981, rising to become President of that company. Nicandro joined the Management Board in 2006 as Regional Director for the Africa and Middle East region and joined the Board in 2008 as Chief Operating Officer.

Ben Stevens
Finance Director (57)

Nationality: British

Position: Finance Director since 2008.

Other appointments: Non-Executive Director of ISS A/S.

Skills and experience: Ben joined the Group in 1990 and has broad international experience spanning both senior finance and general management roles. He was Head of Merger Integration following the merger with Rothmans and Chairman and Managing Director of both Pakistan Tobacco Company and British American Tobacco Russia. Ben was appointed to the Management Board in 2001 as Development Director and became Director, Europe, in 2004.

Sue Farr
Non-Executive Director (60)

Nationality: British

Position: Non-Executive Director since February 2015; member of the Nominations and Remuneration Committees.

Other appointments: Special Advisor, Chime Group; NED and Chair of the Corporate Responsibility Committee of Dairy Crest Group plc; NED of Millennium & Copthorne Hotels plc; NED and Chair of the Nominations & Remuneration Committee of Accsys Technologies PLC; NED of Dolphin Capital Investors Limited.

Skills and experience: Sue brings considerable expertise in marketing, branding and consumer issues to the Board. Sue is a former Chairwoman of both the Marketing Society and the Marketing Group of Great Britain. Prior to joining the Chime Group in 2003, where she was Director, Strategic and Business Development until 2015, Sue's career in corporate communications included roles with the BBC and Vauxhall Motors.

Ann Godbehere
Non-Executive Director (61)

Nationality: Canadian/British

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

Other appointments: NED and Chair of the Audit Committee of Rio Tinto plc and Rio Tinto Limited; NED and Chair of the Compensation Committee of UBS Group AG and UBS AG; NED and Chair of the Audit Committee of Prudential plc.

Skills and experience: Ann has more than 25 years' experience in the financial services industry. She spent ten years at Swiss Re Group, latterly as Chief Financial Officer from 2003 to 2007. From 2008 until 2009 she was Chief Financial Officer of Northern Rock during the initial phase of its public ownership. Ann is a Fellow of the Certified General Accountants Association of Canada and a Fellow of the Institute of Chartered Professional Accountants.

Dr Marion Helmes
Non-Executive Director (51)

Nationality: German

Position: Non-Executive Director since 1 August 2016; member of the Audit and Nominations Committees.

Other appointments: Supervisory Board member of Bilfinger SE; NED of NXP Semiconductors N.V.; Vice Chairwoman of the Supervisory Board of ProSiebenSat.1 Media SE; Supervisory Board member of Uniper SE.

Skills and experience: Marion brings significant financial expertise and operational experience gained at an international level having spent her working life managing businesses across Europe, the Americas and Asia. Her extensive career includes Chief Financial Officer positions at Celesio, Q-Cells and ThyssenKrupp Elevator Technology.

Savio Kwan
Non-Executive Director (68)

Nationality: British

Position: Non-Executive Director since 2014; member of the Nominations and Remuneration Committees.

Other appointments: Co-Founder and CEO of A&K Consulting Co Ltd, advising entrepreneurs and their start-up businesses in China; Visiting Professor at Henley Business School; Non-Executive Director of the Alibaba Hong Kong Entrepreneur Fund.

Skills and experience: Savio brings significant business leadership experience of Greater China and Asia to the Board. During his extensive career he has worked broadly in technology for General Electric, BTR plc and Alibaba Group, China's largest internet business, where he was both Chief Operating Officer and, later, a Non-Executive Director.

Dr Pedro Malan
Non-Executive Director (74)

Nationality: Brazilian

Position: Non-Executive Director since February 2015; member of the Audit and Nominations Committees.

Other appointments: Chairman of the International Advisory Board of Itaú Unibanco; member of the Board of EDP – Energias do Brasil SA; Trustee of the Thomson Reuters Trust Principles; member of the Temasek International Panel.

Skills and experience: Pedro has extensive experience of Brazilian trade and industry and an in-depth knowledge of the international economy. Pedro was Minister of Finance for Brazil from 1995 to 2002, having been President of the Central Bank of Brazil from 1993 to 1994, and before that Chief External Debt Negotiator for Brazil from mid-1991 to 1993. He is a former Chairman of Unibanco and was NED of Souza Cruz S.A. from 2010 to 2015.

Dr Gerry Murphy
Non-Executive Director (61)

Nationality: Irish

Position: Non-Executive Director since 2009; member of the Audit and Nominations Committees. Gerry will retire from the Board at the conclusion of the 2017 AGM.

Other appointments: Chairman of the Executive Committee of The Blackstone Group International Partners LLP; Chairman of Ideal Shopping Direct; Supervisory Board member of Intertrust N.V. and Jack Wolfskin; Chair of the Invest Europe association; Chairman-designate of Tate & Lyle PLC.

Skills and experience: Gerry brings wide-ranging senior board level and general management experience to the Board. He was Chief Executive Officer of Kingfisher plc, Carlton Communications plc, Exel plc and Greencore Group plc, and held senior operating roles at Grand Metropolitan plc (now Diageo plc).

Dimitri Panayotopoulos
Non-Executive Director (65)

Nationality: Greek/Tanzanian

Position: Non-Executive Director since February 2015; Chairman of the Remuneration Committee since 1 October 2016 and member of the Nominations Committee.

Other appointments: Senior Advisor at The Boston Consulting Group; NED of Logitech International S.A.

Skills and experience: Dimitri has extensive general management and international sales and brand building expertise. He was Vice Chairman and Advisor to the Chairman and CEO of Procter & Gamble (P&G), where he started his career in 1977. During his time at P&G, Dimitri led on significant breakthrough innovations and continued to focus on this, speed to market and scale across all of P&G's businesses while Vice Chairman of all the Global Business Units.

Attendance at Board meetings in 2016

Name	Director since	Attended/Eligible to attend: Scheduled	Ad hoc
Richard Burrows	2009	6/6	3/3
Nicandro Durante	2008	6/6	3/3
Ben Stevens	2008	6/6	3/3
Sue Farr	2015	6/6	3/3
Ann Godbehere	2011	6/6	3/3
Dr Marion Helmes[3(c)]	2016	3/3	2/2
Savio Kwan	2014	6/6	3/3
Dr Pedro Malan[1(e)]	2015	6/6	2/3
Christine Morin-Postel[1(e),3(d)]	2007–2016	6/6	2/3
Dr Gerry Murphy[3(e)]	2009	6/6	3/3
Dimitri Panayotopoulos[1(c)]	2015	6/6	2/3
Kieran Poynter	2010	6/6	3/3
Karen de Segundo[3(b)]	2007–2016	2/2	1/1
Dr Richard Tubb[1(d),3(b)]	2013–2016	1/2	0/1

Notes:

1. Number of meetings in 2016: (a) the Board held nine meetings in 2016, three of which were held at short notice, one to approve the removal of the CSR Committee and agree consequent Committee changes and two to discuss the proposed acquisition of Reynolds American ; (b) one meeting was held off site, in Italy, to review the Group's strategy and the Group's Western Europe regional businesses; (c) Dimitri Panayotopoulos missed the 2016 AGM and the April Board meeting arranged at short notice, due to injury; (d) Dr Richard Tubb missed the 2016 AGM and both April Board meetings, due to family illness; (e) Dr Pedro Malan and Christine Morin-Postel missed the Board meeting arranged at short notice on 13 October due to prior commitments.
2. Number of meetings in 2017: Six Board meetings are scheduled for 2017.
3. Composition: (a) the Board of Directors is shown as at the date of this Annual Report; (b) Karen de Segundo and Dr Richard Tubb retired as Non-Executive Directors at the AGM on 27 April 2016; (c) Dr Marion Helmes was appointed as a Non-Executive Director on 1 August 2016; (d) Christine Morin-Postel retired as a Non-Executive Director on 6 December 2016; and (e) Dr Gerry Murphy will retire as a Non-Executive Director at the AGM on 26 April 2017.

Directors' Report

Management Board

Jerome Abelman
Director, Legal & External Affairs and General Counsel (53)

Nationality: US

Jerry was appointed Director, Legal & External Affairs and General Counsel in May 2015, having joined the Management Board as Group Corporate & Regulatory Affairs Director in January 2015. He has been with the Group for 14 years and has held a number of roles in Legal. Jerry was Regional General Counsel, Asia-Pacific from 2010 to 2014, before becoming Assistant General Counsel – Corporate & Commercial. Jerry joined the Board of the Group's associate company, Reynolds American, in February 2016.

Jack Bowles
Regional Director, Asia-Pacific (53)

Nationality: French

Jack became Regional Director for Asia-Pacific in January 2013. Joining the Group in 2004, he was Chairman of British American Tobacco France in 2005, before taking up the role of Managing Director of British American Tobacco Malaysia in 2007. He joined the Management Board as Regional Director for Western Europe in October 2009 before becoming Regional Director for the Americas in October 2011.

Alan Davy
Director, Operations (53)

Nationality: British

Alan was appointed to the Management Board as Group Operations Director in March 2013. He joined the Group in 1988 and has held various roles in manufacturing, supply chain and general management. Alan previously held the position of Group Head of Supply Chain.

Giovanni Giordano
Director, Group Human Resources (51)

Nationality: Italian/US

Giovanni joined the Management Board of British American Tobacco in June 2011. He is an international human resources executive with wide experience from senior roles at Procter & Gamble and Ferrero, where he was Chief Corporate Officer.

Andrew Gray
Director, Marketing (52)

Nationality: Brazilian/British

Andrew was appointed Marketing Director in September 2014. He joined the Management Board as Regional Director for Africa and the Middle East in January 2008 before being appointed Regional Director for Eastern Europe, Middle East and Africa (EEMEA) in January 2011. Joining Souza Cruz as an intern in 1986, he went on to hold a number of senior management positions in South America and the Caribbean (including President of Souza Cruz) and also in Malaysia.

Tadeu Marroco
Regional Director, Western Europe (50)

Nationality: Brazilian

Tadeu was appointed Regional Director, Western Europe in December 2016. He joined the Management Board as Director, Business Development in September 2014. Tadeu joined British American Tobacco in Brazil over 20 years ago. He has held various senior finance positions, including Regional Finance Controller, EEMEA, and Group Finance Controller.

Dr David O'Reilly
Group Scientific Director (50)

Nationality: British

David was appointed Group Scientific Director in January 2012. He has been with British American Tobacco for over 20 years and has held various positions in Group Research and Development. He has led the Group's R&D efforts to develop reduced toxicant products and has also been Head of International Public Health & Scientific Affairs, responsible for engagement with the scientific, medical and public health communities.

Ricardo Oberlander
Regional Director, Americas (53)

Nationality: Brazilian

Ricardo joined the Management Board as Regional Director for the Americas in January 2013. He joined Souza Cruz in May 1989 and has held various roles including Marketing Director of our Malaysian business, Regional Marketing Manager for the Americas, General Manager in France and Global Consumer Director. Ricardo joined the Board of the Group's associate company, Reynolds American, in December 2014 and was appointed to the Chief Marketing Officer (CMO) Council Latin America Advisory Board in February 2016.

Naresh Sethi
Director, Business Development (50)

Nationality: Australian/Indian

Naresh was appointed Director, Business Development in December 2016. He has over 20 years of experience in the tobacco industry, holding various marketing roles in India, Indonesia, West Africa and Australasia before moving to Japan. He was Marketing Director in Japan and then the Group's General Manager. He became Group Head of Strategy and Planning, was appointed Director, Group Business Development in 2012 and was appointed Regional Director for Western Europe in January 2013.

Johan Vandermeulen
Regional Director, Eastern Europe, Middle East and Africa (49)

Nationality: Belgian

Johan joined the Management Board as Regional Director for Eastern Europe, Middle East and Africa in September 2014. He has been with British American Tobacco for more than 20 years and was previously General Manager in Russia, General Manager in Turkey and in the marketing function he was Global Brand Director for the Kent brand.

Kingsley Wheaton
Managing Director, Next Generation Products (44)

Nationality: British

Kingsley was appointed Managing Director, Next Generation Products in January 2015. He joined the Group in 1996 and has held a number of roles in Marketing. He was Marketing Director in Nigeria and Russia, before becoming General Manager in Russia. He was then the Global Brand Director responsible for the Kent and Vogue brands, before taking his place on the Management Board in January 2012 as Deputy Corporate and Regulatory Affairs Director. In June 2012 he was appointed Director, Corporate and Regulatory Affairs.

Directors' Report

Leadership and effectiveness

Governance framework

The Board

The Board is collectively responsible to shareholders of the Company for its performance and for the Group's strategic direction, its values and its governance. It provides the leadership necessary for the Group to meet its performance objectives within a robust framework of internal controls.

Board responsibilities:

- Group strategy.
- Significant corporate activities.
- Group policies.
- Corporate governance.
- Board succession plans.
- Group budget.
- Risk management and internal control.
- Annual Report approval.
- Periodic financial reporting.
- Dividend policy.

Board Committees

The Board has three principal Board Committees to which it has delegated certain responsibilities. The roles, memberships and activities of these Committees are described in their individual reports in this section. Each Committee has its own terms of reference, available at www.bat.com/governance, which are reviewed and updated regularly, most recently with effect from September 2016. To achieve improved alignment with the Group's existing corporate governance framework at a regional level and to further enhance reporting and reduce duplication, a review of the Company's Board Committees in April 2016 resulted in the removal of the Corporate and Social Responsibility Committee with effect from 28 April 2016. The matters reserved for the Committee have been absorbed by the Board, the Audit Committee or management as appropriate.

Board programme

The Board has a comprehensive annual programme of meetings to monitor and review the Group's strategy across all the elements of the Group's business model. These were refreshed in 2016 to include deep dives on key strategy deliverables at each Board meeting. The key activities of the Board in 2016, grouped under the Group's four strategy pillars of Growth, Productivity, Sustainability and Winning Organisation, are detailed on pages 36-37. The Board's strategic priorities for 2016 are identified within the key performance indicators set out in our Strategic Report on page 10.

The Board devotes considerable attention to Group Corporate Governance, including internal control and compliance issues. It receives verbal updates from the Chairmen of all Committees following each Committee meeting. Copies of the minutes of all Committees are circulated to all members of the Board.

Audit Committee page 42

Nominations Committee page 46

Remuneration Committee page 56

Management Board

The Management Board, chaired by the Chief Executive, is responsible for overseeing the implementation of the Group's strategy and policies set by the Board, and for creating the framework for the day-to-day operation of the Group's operating subsidiaries. Its other members comprise the Finance Director and 11 senior Group executives whose names and roles are described on the previous page.

Leadership roles and responsibilities

Leadership

Chairman

- Leadership of the Board.
- Ensures Board effectiveness.
- Sets Board agenda.
- Interfaces with shareholders.
- Ensures effective shareholder engagement.

Chief Executive

- Overall responsibility for Group performance.
- Leadership of the Group.
- Enables planning and execution of objectives and strategies.
- Stewardship of Group assets.

Oversight

Non-Executive Directors (NEDs)

- Oversee Group strategy.
- Review management proposals.
- Monitor Group performance.
- Bring an external perspective and effective challenge to the Board.

Senior Independent Director (SID)

- Leads review of Chairman's performance.
- Presides at Board in Chairman's absence.
- Intermediary for other Directors.
- Available to meet with major shareholders.

Management Board

- Development of Group strategy for Tobacco Products and Next Generation Products for approval by the Board.
- Monitoring Group operating performance.
- Ensuring Group, regional and functional strategies and resources are effective and aligned.
- Managing the central functions.
- Overseeing the management and development of talent.

Directors' Report

Board activities in 2016

Growth

Growth remains our key strategic focus. Continued investment in and development of our strategic focus areas is central to the Board's annual agenda.

Activities in 2016

Reviewing:

- delivery of the Group's strategy, in particular the implementation of a number of key strategic objectives to ensure that the Group Strategy remains relevant in light of evolving global trends and on track to deliver results;
- the Group's proposed acquisition of Reynolds American, including the strategic rationale and stakeholder engagement;
- operating performance and the continued impact of foreign exchange rates on the Group's financial performance, including measures taken by management to mitigate the foreign exchange risks;
- the quarterly financial performance of the Group's associate companies;
- combustible business strategy, including the Group's consumer insights which inform its brand strategies; receiving a detailed update on the macro-economic environment in the Group's key markets; considering the Group's revised approach towards marketing investment choices and brand building relating to the Group's five Global Drive Brands by segment and market typology on a market-by-market basis; discussing the changing landscape for tobacco consumers and the impact of issues such as illicit trade; and
- the Group's results and current outlook throughout the year.

Strategy review highlights: Growth

NGP – reviewing the Group's NGP performance and ambition for 2020, including expansion of the NGP portfolio across Western Europe and into the Americas; considering updates on launches of Vype and glo, the Group's first Tobacco Heating Product; noting the acquisition of Ten Motives, a UK e-cigarette company and evaluating further strategic collaborations and acquisitions; receiving updates on scientific and regulatory issues, including the requirements of the recent Tobacco Products Directive in the EU, which introduced regulation for e-cigarettes across Europe.

Western Europe business review – reviewing Western Europe regional issues in depth at the Board away meeting in Rome; receiving presentations by senior management on NGP, Marketing and Finance, and participating in deep dive strategy sessions covering each of the key markets in the region.

Productivity

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

Activities in 2016

Reviewing:

- the final stages and successful completion of the roll-out of the Group's new operating model and global IT solution which will ensure standardisation and more effective management and use of Group data;
- a strategic factory footprint/manufacturing update for Western Europe, including the closure of a factory in Bayreuth in Germany by the end of 2017 and the transfer of production to existing factories in Poland, Romania, Hungary and Croatia;
- proposals to rationalise the Board's principal sub-committees including the removal of the Corporate and Social Responsibility Committee and the re-allocation of that Committee's former responsibilities; agreeing to amend membership of the remaining Committees to facilitate the holding of simultaneous meetings of the Audit and Remuneration Committee; and
- Group liquidity, confirming that the Company was conforming with its financing principles, and noting planned refinancing activities for the year ahead.

Strategy review highlights: Productivity

Global Business Services – reviewing a proposal to merge all shared service centres from Finance, HR and IT into a single Global Business Services function, following the successful roll-out of TaO, including enhancements to Finance Shared Services, the implementation of a global HR Shared Services function and an IT transformation programme which will remove remaining legacy systems.

Sustainability

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

Activities in 2016

Reviewing:

- the Group's regulatory strategy in the context of the current regulatory landscape, including receiving a detailed update on the EU Tobacco Products Directive (TPD) covering the history of the adoption of the EU TPD, the different approaches which some countries have taken to the issues being regulated, issues of interpretation and the consequent supply chain challenges faced by the Group;
- the progress being made with regard to establishing the Group's NGPs as potentially reduced risk products, including a summary of the current view of the risk spectrum and the findings of a number of internal scientific studies to be published in peer-reviewed journals, which support the Group's position that certain NGPs in the portfolio could be considered as potentially reduced risk products;
- the status of the Group's litigation proceedings, including updates on the class actions in Quebec, Canada, against the Group's subsidiary Imperial Tobacco Canada and two other Canadian manufacturers, the legacy litigation in relation to pollution in the US (Fox River and Kalamazoo River), the Sequana dividend trial, pending decisions in the UK Plain Packaging and EU TPD2 challenges and a tax case in Bangladesh;
- Environment, Health and Safety performance and long-term targets; and
- the Group's Risk Register, in particular the degree of risk to the Group associated with Brexit; considering the Group's risk appetite and determining the Group's viability for Financial Reporting Council reporting purposes, taking account of the Company's current position and principal risks.

Strategy review highlights: Sustainability

Update on investigation into allegations made towards the end of 2015 regarding historic misconduct in Africa.

As reported in last year's Annual Report, towards the end of 2015, a number of allegations were made regarding historic misconduct in Africa. We are investigating, through external legal advisers, allegations of misconduct and are liaising with the Serious Fraud Office and other relevant authorities. The Board also created a sub-Committee of the Board to specifically monitor matters, having regard to the need to ensure active oversight of and support for the investigation between Board meetings. In 2016, the Group began a project, which will continue into 2017, to review and further strengthen all aspects of the Group's global compliance procedures. This important project will create a centre of excellence to champion and guide the Group's Standards of Business Conduct programme.

Winning Organisation

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

Activities in 2016

Reviewing:

- the current Remuneration Policy and approving a new Remuneration Policy, together with revised 2016 LTIP Rules and Sharesave Rules for presentation to shareholders;
- succession planning at Board level, including Executive Director and Management Board succession planning and monitoring the progress of Management Board development plans;
- the performance of Executive Directors and Management Board members;
- the required skills sets for Non-Executive Directors and specific Board roles and appointment to these roles as proposed by the Nominations Committee;
- the composition of Board Committees and approving the re-allocation of work from the Corporate and Social Responsibility Committee to the Board, the Audit Committee and management, as appropriate; and
- considering and approving changes in nominated directorships to the Group's significant associated companies.

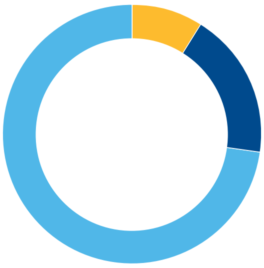
Strategy review highlights: Winning Organisation

Receiving an update on the key programmes underpinning the Group's investment in leaders, in particular the work of the Diversity and Inclusion programme which seeks to drive ownership and accountability, build diverse talent pools and improve the diversity of the Group's senior grades against the Group's diversity ambitions as well as a review of the Group's graduate scheme.

Directors' Report

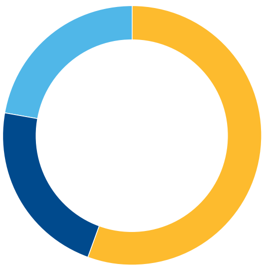
Board effectiveness

Balance of Non-Executive Directors and Executive Directors



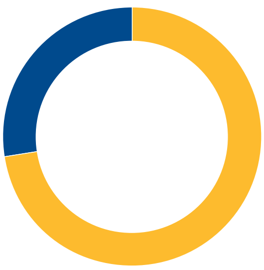
Chairman	1	Independent Non-Executive Directors	8
Executive Directors	2		

Length of tenure of Non-Executive Directors



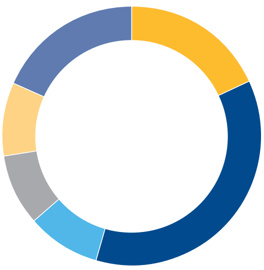
0–3 years	5	7+ years	2
4–6 years	2		

Gender split of Directors



Male	8	Female	3

Nationality of Directors



Brazilian	2	German	1
British	4	Greek	1
Canadian	1	Irish	2

Balance and diversity

Our Non-Executive Directors come from broad industry and professional backgrounds, with varied experience and expertise aligned to the needs of our business. Short biographies of the Directors are set out in this section on pages 32–33. In 2016, 27% of our Board was female.

The Board appreciates the benefit of diversity in all its forms, within its own membership and at all levels of the Group. Our Strategic Report contains details of our diversity policy, including the proportion of women in our total workforce and in senior management, on pages 13–14.

Independence and conflicts of interest

Independence

The Board considers all Non-Executive Directors to be independent, as they are free from any business or other relationships that could interfere materially with, or appear to affect, their judgement.

Conflicts of interest

The Board has formal procedures for managing conflicts of interest. Directors are required to give advance notice of any conflict issues to the Company Secretary. These are considered either at the next Board meeting or, if the timing requires it, at a meeting of the Board's Conflicts Committee. Each year, the Board also considers afresh all previously authorised situational conflicts. Directors are excluded from the quorum and vote in respect of any matters in which they have an interest. No material conflicts of interest arose during 2016.

Information and professional development

Board induction

On joining the Board, all Directors receive a full induction. Non-Executive Directors also receive a full programme of briefings on all areas of the Company's business from the Executive Directors, members of the Management Board, the Company Secretary and other senior executives.

Dr Marion Helmes received a comprehensive induction in 2016, including briefings covering the Group's Strategy, its functions (including Marketing and Next Generation Products), statutory reporting cycle, Group Treasury, IT strategy, and legal and regulatory issues. She, along with the rest of the Board, also had the opportunity to conduct a market visit in Rome at the off-site Board meeting to review the Group's strategy and the key Western Europe businesses.

Non-Executive Directors are encouraged to attend meetings of the Group's regional Audit and Corporate and Social Responsibility Committees to gain a better understanding of issues in the Group's regions.

The Chairman meets with each Non-Executive Director individually, in the latter part of each year, to discuss their individual training and development plans.

Training and development: The Market Abuse Regulation

A comprehensive training programme was undertaken to ensure that the Directors and key personnel understood the significant changes to the Company's procedures and policies as well as their own individual obligations relating to both share dealing and the management of inside information as a result of the implementation of the provisions of the Market Abuse Regulation (MAR) in July 2016.

The Board adopted a simplified and revised internal Code for Share Dealing and amended the Group's Standards of Business Conduct to reflect the new MAR obligations. It also approved new and expanded terms of reference for its Disclosure Panel to reflect these changes.

Shareholder engagement

The Chairman and the Executive Directors are committed to open and transparent dialogue with shareholders. In early 2016, both the Chairman and the then Chairman of the Remuneration Committee met several shareholders, in particular to discuss the outcomes of the remuneration consultation and the proposed final amendments to the Group's Remuneration Policy.

The Senior Independent Director and other Non-Executive Directors are also available to meet with major shareholders on request. No such requests were received in 2016.

The AGM is an opportunity for further shareholder engagement and for the Chairman to explain the Company's progress and, along with other members of the Board, to answer any questions. All Directors attend, unless illness or pressing commitments prevent them. All Directors, except for Dr Richard Tubb and Dimitri Panayotopoulos, attended the AGM in 2016. Details of our 2017 AGM are set out in the Other corporate disclosures section.

Annual investor relations programme

A full programme of engagement with shareholders, potential investors and analysts, in the UK and overseas, is undertaken each year by the Head of Investor Relations, often accompanied by one or more Executive Directors. In 2016, meetings were held with institutional shareholders in 19 countries, spanning five continents, engaging with the owners of the majority of its shares. Regular investor presentations were also given and these together with the results presentations are published on www.bat.com. All results presentations are also available to shareholders by webcast.

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

Board reporting on shareholder views

In 2016, the Head of Investor Relations updated the Board on key issues raised by institutional shareholders as well as a commentary on share price performance. The Chairman also regularly reports on any meetings he has had with shareholders in between Board meetings and the Board discusses the key points investors may have raised and, in 2016, the Board received an update on the outcome of the Chairman's meeting with the Investment Association over its Board Confidence index.

Board evaluation

Evaluation process

Under the UK Corporate Governance Code there is a requirement that a Board should undertake a "formal and rigorous annual evaluation of its own performance and that of its committees and individual directors". Evaluation of the boards of FTSE 350 companies should be externally facilitated at least every three years. Independent Audit Limited facilitated BAT's evaluation of its effectiveness for 2016.

The performance and effectiveness of the Board, its Committees, the Executive and Non-Executive Directors and the Chairman were evaluated. Respondents were requested to rank the Board against several outcomes. They also had the opportunity to elaborate their replies by providing specific comments. All Non-Executive Directors and Executive Directors participated in the evaluation process. This year, a small number of senior managers and external advisors who regularly attend Board Committee meetings, including the Company Secretary and the Director, Legal & External Affairs, were also invited to complete the evaluation.

Constructive feedback

Anonymised reports were prepared by Independent Audit Limited for the Board and each Board Committee on the results of the evaluation. In addition, the Chairman received reports on the performance of each of the Executive and Non-Executive Directors. A report on the Chairman's own performance was prepared for the Senior Independent Director. Individual feedback was given by the Chairman to all Board members, and by the Senior Independent Director to the Chairman.

The results of the evaluation show that the Board continues to function well and each of its Committees continues to be efficient and effective. Relations between the executives and the non-executives are good. Key strengths of the Board include the wide range of skills and diverse backgrounds of members, the excellence of the management team and Chairman, and the collegiate atmosphere. Board members generally have a good understanding of the business and their roles and receive the information they need. They are also well supported by the Company Secretary.

The report noted that the Board has a strong desire to continue to improve Board effectiveness in all areas.

A summary of the key points arising from the evaluation, our progress against 2016 action points and proposed actions for 2017, is set out on pages 40–41.

Collective Board effectiveness

Collective decision-making

The Chairman seeks a consensus at Board meetings but, if necessary, decisions are taken by majority. If any Director has concerns on any issues that cannot be resolved, such concerns are noted in the Board minutes. No such concerns arose in 2016.

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

For disclosures required by paragraph 7.2.6 of the Disclosure Guidance and Transparency Rules and the Companies Act 2006 see the Other corporate disclosures section on pages 77–82.

Board effectiveness continued

Board evaluation 2016

Leadership

"The Board works well...the performance of the Board is linked to the performance of the Company…and the Company is doing very well."

Findings

The Board has a clear understanding of the Group's business and the environment in which it operates and scored well on coverage of the right issues and avoiding unnecessary detail.

Strategy discussions take place at every Board meeting and the Board challenges underlying assumptions and seeks clarity and consistency.

Strategy is communicated clearly externally and has been generally well received, for example, the positive reactions to merger and acquisitions activity during the year.

The development of a workable remuneration strategy in conjunction with the Remuneration Committee was noted as an example of the Board and its Committees working very well together and communicating with investors and shareholders in developing a remuneration proposal that received strong support at the AGM.

Action for 2017

Following the revision of the Board's Committee structure, more time will be allocated to Group strategy discussions.

Continued opportunities for interaction with senior management via the attendance at management meetings such as the Regional Audit Committees will also be provided.

To ensure that all Directors are fully aware of any new challenges facing BAT (including those presented in the event of a successful completion of the proposed acquisition of Reynolds American), ensure that detailed briefings and, where appropriate, market visits are arranged and that the challenges and issues are discussed.

Progress against 2016 actions

The Board calendar was revised to provide additional time at each Board meeting for reviewing one or more aspects of the Group's strategy in detail with senior management, covering progress, challenges and opportunities.

Oversight

"I think management do a very good job in drawing the Board's attention to the key importance of regulatory compliance."

Findings

Oversight is well executed and the Board continues to have a clear understanding of controls and risks. The risk register is well defined and each separate risk is mitigated.

Due weight is given to regulatory compliance, in particular the Board's oversight of the investigation into certain allegations regarding historic misconduct in Africa, including the creation of a Board sub-Committee to provide ongoing support between Board meetings.

The Executive Directors are very highly regarded by the Board and excel in presenting and delivering the strategy.

The culture of the Company is well understood and this knowledge is utilised in providing the oversight to develop strategies for change in areas such as NGP.

Action for 2017

A Board sub-Committee will continue to keep the Board fully updated in relation to the outcomes of the Group's investigation into certain allegations regarding historic misconduct in Africa.

Following a review of compliance processes during 2016, the format, content and frequency of reporting of incidents arising under the Group Standards of Business Conduct to the Audit Committee will be reviewed.

Progress against 2016 actions

The performance and published strategies of the Group's competitors are regularly compared to the Group's strategic imperatives, providing context for discussion relating to the Group's strategy. Views of shareholders and the media are also regularly considered.

Shareholder views are fed back to the Board in a formal report from the Head of Investor Relations twice a year. All Directors also receive briefing reports following significant events or whenever the Group is in the news.

Meetings

"Board meetings are managed very well indeed, resulting in outstanding time utilisation."

Findings

The annual Board programme continues to be comprehensive with all key issues being covered. Papers are of a high quality with very thorough documentation. Board meetings finish on time.

The Chairman sets a positive and constructive tone at meetings and is effective in dealing with any unconstructive behaviour or sources of tension.

All Board members are encouraged to participate in discussions and contribute their input.

The ability of the Chairman to identify consensus and move to a timely conclusion was particularly identified as a strength.

Action for 2017

With effect from 1 January 2017, meetings of the Audit and Remuneration Committees will be held concurrently with a view to maximising the use of time and the effectiveness of each Committee and the Board.

Progress against 2016 actions

Committee memberships and the scheduling of Committee meetings were reviewed during 2016, with a view to maximising the effectiveness of each Committee, and of the Board, within the overall time allocated for each meeting schedule. This resulted in the cessation of the Corporate and Social Responsibility Committee and the re-distribution of its responsibilities among the Board, Audit Committee and management.

Several informal Non-Executive Director-only discussions were scheduled during 2016.

Support

"We have an outstanding secretariat giving NEDs excellent and timely support in all areas."

Findings

The Board continues to receive excellent support from management and the Company Secretary.

The Board evaluation process itself was described as a "good experience" which "forces Board members to think through a very wide range of issues". The decision to include some members of senior management and some outside advisers in this year's evaluation was also welcomed.

Action for 2017

Assuming the proposed acquisition of Reynolds American completes and the Group's ADR listing in the US is upgraded to a Level III SEC listing, provide a detailed briefing and training session for the Board on their responsibilities under the relevant legislative and regulatory codes.

Ensure any new Directors joining the Board, particularly any joining from the Reynolds American Board on completion of the merger, receive a full induction on the Group's businesses outside of the US.

Progress against 2016 actions

The entire Board received detailed training on their duties and the duties of the Company under the Market Abuse Regulation, which came into force on 3 July 2016. A detailed briefing on the Group's innovation initiatives was also well received.

Composition

"Board members are high calibre with a wide range of appropriate skills."

Findings

The Board continues to have a good mix of broad and diverse skills, nationalities, experience and talent. These have been further enhanced with the appointment of Dr Marion Helmes in August 2016, who brings significant financial expertise and operational experience skills to the Board.

Action for 2017

Committee succession was an area for discussion in 2016. Following the Board Evaluation exercise, improvements to succession planning for Committees have been identified.

Progress against 2016 actions

The Board Committee structure and composition was refreshed during 2016.

The appointment of Non-Executive Directors with diverse skills, nationalities and gender continued to be a focus. A new Non-Executive Director, Dr Marion Helmes, was appointed to the Board with effect from 1 August 2016.

Working together

"The Board is a supportive and friendly place where people can express their views."

Findings

Directors listen to and respect the views of others, contribute to a constructive atmosphere in the Boardroom and work within a consensus position once it is established.

The Chairman and the Chief Executive Officer work very well together with complementary personal styles and help set the "tone at the top".

Action for 2017

Ensure that opportunities to engage with senior management continue as these are extremely useful in understanding strategy implementation and that Non-Executive Directors' ability to evaluate candidates for Executive succession is effective.

Provide scheduled NED-only meetings in the Board calendar rather than the ad hoc arrangement as currently. Discussions between NEDs separately from Executive Directors have been valuable in improving the effectiveness of the Board as a whole in 2016.

Progress against 2016 actions

The Board received detailed updates from senior management on key strategic matters throughout the year. The Board also undertook a market visit and met with and discussed the challenges and opportunities faced by the leadership team in Western Europe during the Board meeting held in Rome.

The additional strategic deep dives during 2016 have provided opportunities for Non-Executive Directors to engage with senior management.

Directors' Report

Audit Committee

Kieran Poynter
Chairman of the Audit Committee

Audit Committee current members
Kieran Poynter (Chairman)
Dr Marion Helmes
Dr Pedro Malan
Dr Gerry Murphy

Attendance at meetings in 2016

Name	Member since	Attendance/Eligible to attend
Ann Godbehere[3(d)]	2012–2016	3/3
Dr Marion Helmes[3(c)]	2016	2/2
Dr Pedro Malan[3(b)]	2016	3/3
Christine Morin-Postel[3(f)]	2014–2016	5/5
Dr Gerry Murphy	2015	5/5
Kieran Poynter[1,3(e)]	2012	5/5

Notes:
1. Kieran Poynter has recent and relevant financial experience.
2. Number of meetings in 2016: The Committee held five meetings in 2016, all of which were scheduled.
3. Membership: (a) all members of the Committee are independent Non-Executive Directors in accordance with Code Provision C.3.1.; (b) Dr Pedro Malan joined the Committee on 28 April 2016; (c) Dr Marion Helmes became a member of the Committee on 1 August 2016 following her appointment as a Non-Executive Director; (d) Ann Godbehere ceased to be a member of the Committee on 1 October 2016; (e) Kieran Poynter became Chairman of the Committee, replacing Christine Morin-Postel, with effect from 1 October 2016, having previously chaired the Committee from April 2013 to May 2015; and (f) Christine Morin-Postel ceased to be a member of the Committee upon her retirement as a Non-Executive Director on 6 December 2016.
4. The Finance Director attends all meetings of the Committee but is not a member. Other Directors may attend by invitation. The Director, Legal & External Affairs, the Group Head of Audit, and the external auditors also attend meetings on a regular basis.
5. The Committee meets alone with the external auditors and, separately, with the Group Head of Audit, at the end of every meeting.

For the Committee's terms of reference see
www.bat.com/governance

Role

The Audit Committee monitors and reviews the:

- integrity of the Group's financial statements and any formal announcements relating to the Company's performance, considering any significant issues and judgements reflected in them, before their submission to the Board;
- consistency of the Group's accounting policies;
- effectiveness of, and makes recommendations to the Board on, the Group's accounting, risk and internal control systems;
- effectiveness of the Company's internal audit function; and
- performance, independence and objectivity of the Company'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.

Key activities in 2016

Regular work programme – reviewing:

- the application of accounting standards, the Group's 2015 results, 2016 half-year results, the interim management statements and the external auditors' reports where results are audited;
- the Basis of Preparation and Accounting Judgements;
- the internal processes that had been followed for the preparation of the Report and Accounts and confirming that the processes appropriately facilitated the preparation of an annual report that is 'fair, balanced and understandable';
- the review on the year-end audit from the Group's external auditors, including the key audit risks, the Group's control environment and the final materiality assessment and confirming the independence of the external Group auditors;
- the Group's liquidity position, current facilities and financing needs through 2016;
- the steps taken to validate the Group's 'going concern' assessment at half-year and year-end and agreeing the process steps taken to determine the Group's viability statement at year-end;
- the 2017 Internal Audit Plan;
- periodic reports from the Group's regional Audit and CSR Committees and Corporate Audit Committee;
- the Group's Risk Register, including the categorisation of, and mitigating factors in respect of, Group risks;
- regular reports from the Group Head of Audit and Business Risk on international and global process audits and the management responses and action plans being put in place to address any concerns raised;
- the annual assessment of goodwill impairment;
- the annual report from the Head of Group Security on security risks and frauds and losses arising during the preceding year;
- quarterly and annual reports on compliance with the Group's Standards of Business Conduct and biannual reports on political contributions; and
- the Audit Committee effectiveness following the Board evaluation process.

Further specific matters considered by the Committee:

- agreeing amendments to the Global Policy on Auditor Independence to reflect legislative changes and recommending them for adoption by the Board with effect from 1 January 2017;
- recommending amendments to the Audit Committee Terms of Reference following discussions on the allocation of agenda items previously considered by the CSR Committee and recommending them for adoption by the Board;
- recommending amendments to the Group's travel insurance policies for Directors;
- receiving an update on the information requirements of BEPS measures including Country by Country reporting;
- agreeing changes to audit scope and coverage for the full-year audit following the successful completion of the roll-out of TaO; and
- recommending that quarterly reporting ceases and that the first and third quarter interim management statements be replaced with brief Trading Updates.

Risk topics considered by the Committee included:

- an update on key litigation involving the Group with a specific focus on the healthcare recoupment claims across Canada and the class action claim against the Group's subsidiary, Imperial Tobacco Canada (ITCAN) in Quebec Province;
- an overview, following the successful completion of the five-year TaO programme, of how the new system is being used to create opportunities for additional efficiencies, for example in HR Shared Services, and how the integrity of the system will be managed on a business-as-usual basis, helping the Group move towards its goal of establishing a globally integrated enterprise;
- a review of emerging risks and the risks posed by the UK's recent decision to exit the EU;
- proposed revisions to the Group's risk appetite framework as it relates to each of the Company's strategic objectives;
- an update on the latest trends with regard to cyber-attacks and on the Group's priorities for ensuring continuing protection;
- the rationale and the proposed approach to Coordinated Assurance and the adoption of a 'Three Lines of Defence' model within the Group, to be implemented in phases in 2017; and
- risks (and proposed mitigations) relating to the closure of factories in Malaysia and Germany.

Significant accounting judgements considered by the Committee in relation to the 2016 accounts:

- **the Group's significant corporate tax exposures:** the Committee was updated periodically on corporate tax matters and considered reports from the Group Head of Tax on the current status of issues in various markets. These included significant tax disputes in Brazil, South Africa, Bangladesh and the Netherlands. The Committee agreed with management's position and extended disclosures in respect of them (see note 28 in the Notes on the Accounts);
- **contingent liabilities, provisions and deposits in connection with ongoing litigation:** the Committee reassessed the provision in respect of the Fox River clean-up costs and related legal expenses subsequent to a funding agreement in relation to the sharing of the costs. As a result, the provision was increased (see note 3 in the Notes on the Accounts). However, inherent uncertainties remain (see note 30 in the Notes on the Accounts). The Committee agreed that no provision should be recognised at this point in time in respect of the Kalamazoo River claim. The Committee also agreed that the quarterly deposits in relation to security for costs in relation to the Quebec Class Action, made by the Group's subsidiary Imperial Tobacco Canada, would be treated as an asset to be recovered upon a successful appeal of the original judgment (see note 14 in the Notes on the Accounts);
- **foreign exchange and restricted cash:** as the Group has operations in certain territories with severe currency restrictions, where foreign currency is not readily available, the Committee satisfied itself that the methodologies used to determine relevant exchange rates for accounting purposes remained appropriate (for restricted cash, see note 19 in the Notes on the Accounts).

External auditors

KPMG LLP (KPMG) have been the Company's auditors since 27 March 2015. The Committee considers that the relationship with the auditors is working well and is satisfied with their effectiveness.

Auditor independence policy

The Committee has an established policy to safeguard the independence and objectivity of the Group's external auditors. The key principle of the policy is that the Group's external auditors may be engaged to provide services only in cases where those services do not impair their independence and objectivity. The external auditors may not be engaged to provide services if the provision of such services would result in the external auditors:

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

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

The Committee also reviews a work plan identifying the total fees for all audit-related services, tax services and other non-audit services that it is expected will be undertaken by the external auditors in the following year. Tax services and other non-audit services in excess of the tender thresholds referred to above must be itemised. Updated work plans are also submitted to the Committee at the mid-year and year-end, so that it has full visibility of the Group spend on non-audit services.

A breakdown of audit, audit-related and non-audit fees paid to KPMG firms and associates in 2016 is provided in note 3(c) in the Notes on the Accounts and is summarised as follows:

Services provided by KPMG firms and associates 2016

	2016 £m	2015 £m
Audit services	**9.2**	8.7
Audit-related assurance services	**0.2**	0.2
Total audit and audit-related services	**9.4**	8.9
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
Total non-audit services	**2.0**	3.1

Note:
In 2016, non-audit fees paid to KPMG amounted to 21.3% of the audit and audit-related assurance fees paid to them (2015: 35%).

On 1 January 2017, the Group's revised Global Policy on Auditor Independence took effect to ensure compliance with the EU Audit Directive and Regulation. In particular, the Group Auditor will withdraw from tax, excise duty strategy/government policy and illicit trade advice to mitigate any perceived threat to independence from this type of work. In addition, non-audit fees will be limited to 70% of the Company's average audit fees over the previous three consecutive financial years.

Audit Committee continued

Annual assessment

The Committee carries out an annual assessment of the Group's external auditors, covering qualification, expertise and resources, and independence, as well as the effectiveness of the audit process. This assessment is informed by an external audit satisfaction survey completed by members of senior management. No material issues were identified during 2016. The Committee is satisfied with the qualification, expertise and resources of its external auditors and that the objectivity and independence of its external auditors is not in any way impaired by the non-audit services which it provides.

The Finance Director, Director, Legal & External Affairs, Group Head of Internal Audit and Business Risk, Company Secretary and the Committee Chairman all meet with the external auditors throughout the year to discuss relevant issues as well as the progress of the audit. Significant issues are included on the Committee's agenda.

Risk management and internal control

Overview

The Company maintains its system of risk management and internal control with a view to safeguarding shareholders' investment and the Company's assets. It is designed to identify, evaluate and manage risks that may impede the Company's objectives. It cannot, and is not designed to, eliminate them entirely. The system therefore provides a reasonable, not absolute, assurance against material misstatement or loss. A description of the principal risk factors that may affect the Group's business is provided in our Strategic Report on pages 26–30. The main features of the risk management processes and system of internal control operated within the Group are described below, and have been in place throughout the year under review and remain in place to date. They do not cover the Group's associate undertakings.

Board oversight

During the year, the Board considered the nature and extent of the principal risks that the Group is willing to take to achieve its strategic objectives (its 'risk appetite') and for maintaining sound risk management and internal control systems. It reviews its risk appetite to ensure that it is appropriate and consistent with internal policies. With the support of the Audit Committee, the Board also carries out a review of the effectiveness of the Group's risk management and internal control systems annually. This review covers all material controls including financial, operational and compliance controls and risk management systems.

Audit and CSR Committee framework

The Group's Audit and CSR Committee framework underpins the Board's Audit Committee. It provides a flexible channel for the structured flow of information through the Group, with committees covering locally listed Group entities or complex markets where considered appropriate in certain markets, and each of the Group's regions. In the EEMEA Region, given the size of the Region and the number of countries it includes, the regional Audit and CSR Committee is supported by an area Audit and CSR Committee. Local Audit and CSR Committees also operate in several markets in EEMEA.

This framework ensures that significant financial, social, environmental and reputational risks faced by the Company and its subsidiaries are appropriately managed and that any failings or weaknesses are identified so that remedial action may be taken.

The Group's regional Audit and CSR Committees are all regularly chaired by an Executive Director and attended by one or more Non-Executive Directors. The Corporate Audit Committee focuses on the Group's risks and control environment that fall outside the regional committees' remit, for example head office central functions, global programmes and projects. It comprises members of the Management Board, is chaired by a Regional Director and is also attended by one or more of the Non-Executive Directors.

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

Risk management

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

At Group level, specific responsibility for managing each identified risk is allocated to a member of the Management Board. The Group Risk Register is reviewed regularly by a committee of senior managers, chaired by the Finance Director. In addition, it is reviewed annually by the Board and twice yearly by the Audit Committee. The Board and the Audit Committee review changes in the status of identified risks, assessing the changes in impact and likelihood. The Audit Committee also conducts deep dives into selected risks, meeting senior managers responsible for managing and mitigating them, so that it can consider those risks in detail.

In 2016, the Board noted that the Group's risk profile remained stable.

The Board also considered the Group Viability Statement see page 26 of the Strategic Report.

For more information on risk factors see the principal Group risk factors section in our Strategic Report on pages 26–30.

Internal control

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

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

The results of these reviews are reported to the relevant regional Audit and CSR Committees or to the Corporate Audit Committee and, where appropriate, to the Audit Committee to ensure that appropriate remedial action has been, or will be, taken where necessary.

Internal audit function

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

Financial reporting controls

The Group has in place a series of policies, practices and controls in relation to the financial reporting and consolidation process, which are designed to address key financial reporting risks, including risks arising from changes in the business or accounting standards and to provide assurance of the completeness and accuracy of the content of the Annual Report (and in particular, to assess whether it is 'fair, balanced and understandable') in accordance with regulatory requirements. The Group Manual of Accounting Policies and Procedures sets out the Group accounting policies, its treatment of transactions and its internal reporting requirements. The internal reporting of financial information to prepare the Group's quarterly interim management statements and half-yearly and year-end financial statements is signed off by the heads of finance responsible for the Group's markets and business units. The heads of finance responsible for the Group's markets and all senior managers must also confirm annually that all information relevant to the Group audit has been provided to the Directors and that reasonable steps have been taken to ensure full disclosure in response to requests for information from the external auditors. The Chairman of the Committee participated in an internal Annual Report drafting meeting and engaged separately with the Finance Director during the drafting process in 2016. The effectiveness of the Group's financial reporting controls are assessed as part of the Control Navigator exercise described above and evaluated by internal audit in the context of the annual audit plan.

Standards of Business Conduct

The Committee is responsible for monitoring compliance with the Company's Standards of Business Conduct (the 'Standards'), which underpin the Group's commitment to good corporate behaviour. The Standards require all staff to act with a high degree of business integrity, comply with applicable laws and regulations, and ensure that standards are never compromised for the sake of results. Every Group company and all staff worldwide, including senior management and the Board, are expected to live up to the Standards. Guidance on them is provided across the Group, including through training and awareness programmes. All Group companies have adopted the Standards or local equivalents.

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

The Standards, and information on the total number of incidents reported under them in 2016 (including established breaches), is available at www.bat.com/sobc.

In the year to 31 December 2016, 174 instances of suspected improper conduct contrary to the Standards were reported to the Committee (2015: 94).

Of the instances reported, 77 were established as breaches and appropriate action taken (2015: 29). In 65 cases, an investigation found no wrongdoing (2015: 43). In 32 cases, the investigation continued at the year-end (2015: 22), including the investigation into certain allegations regarding historic misconduct in Africa.

Whistleblowing

The Standards also set out the Group's whistleblowing policy, enabling staff, in confidence, to raise concerns without fear of reprisal.

The policy is supplemented by local procedures throughout the Group and at the Group's London headquarters, providing staff with further guidance and enabling them to report matters in a language with which they are comfortable. The Committee receives quarterly reports on whistleblowing incidents, often discussing them in detail. While it remains satisfied that the Group's policy and procedures enable proportionate and independent investigation of matters raised and ensure that appropriate follow-up action is taken, the existing procedures will be reviewed by the Group Head of Business Control and Compliance during 2017.

Of the total number of business conduct incidents reported in 2016, set out above, 115 were brought to management's attention through whistleblowing reports from employees, ex-employees, third parties or unknown individuals reporting anonymously (2015: 73).

Political contributions

The Committee is responsible for reviewing donations made for political purposes throughout the Group. The total amount of political donations paid in 2016 was £20,208 (2015: £25,804), as follows:

British American Tobacco Japan Limited reported contributions totalling Japanese yen ¥ 2,980,000 (£20,208) for the full year 2016. This expenditure is reported as a political contribution although it related specifically to the purchase of tickets to receptions or dinners hosted by Members of Parliament (MPs). Representatives from British American Tobacco Japan Limited engaged with these MPs at the receptions on local tobacco tax issues.

No other political donations were reported.

Annual review

The Financial Reporting Council's 'Guidance on Risk Management and Internal Control and Related Business Reporting' reflects the requirements of the UK Corporate Governance Code (the 'Code') regarding the applicability of, and compliance with, the Code's provisions with regard to issues of risk and internal control management and related financial and business reporting.

The processes described above, and the reports that they give rise to, enable the Board and the Committee to monitor the issue of risk and internal control management on a continuing basis throughout the year and to review its effectiveness at the year-end. The Board, with advice from the Committee, has completed its annual review of the effectiveness of that system for 2016.

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

Corporate Social Responsibility Committee (CSR)

The CSR Committee held one scheduled meeting in 2016 before its activities were divided between the Board, the Audit Committee and management. The meeting was attended by all CSR Committee members, namely Karen De Segundo (Chairman), Sue Farr, Savio Kwan, Dr Pedro Malan and Dr Richard Tubb. The meeting covered the following matters:

- annual reviews for Corporate Social Investment (CSI), Youth Smoking Prevention and the International Marketing Principles;
- annual performance and 2016 targets for Environment, Health and Safety;
- Standards incidents with potential reputational impact and stakeholder allegations of a reputational nature;
- an update on the work of the Group's human rights and supply chain due diligence and the requirements of the UK Modern Slavery Act;
- approving a new Supplier Code of Conduct with effect from 1 March 2016 to ensure that BAT's suppliers understand the minimum standards expected from them; and
- an update on Sudan's current political, economic and social position.

Directors' Report

Nominations Committee

Nominations Committee current members

Richard Burrows (Chairman)	Dr Pedro Malan
Ann Godbehere	Dr Gerry Murphy
Sue Farr	Dimitri Panayotopoulos
Dr Marion Helmes	Kieran Poynter
Savio Kwan	

Attendance at meetings in 2016

Name	Member since	Attendance/Eligible to attend
Richard Burrows	2009	5/5
Sue Farr	2015	5/5
Ann Godbehere	2011	5/5
Dr Marion Helmes[2(c)]	2016	1/1
Savio Kwan	2014	5/5
Dr Pedro Malan	2015	5/5
Christine Morin-Postel[2(d)]	2007–2016	5/5
Dr Gerry Murphy	2009	5/5
Dimitri Panayotopoulos[1(b)]	2015	3/5
Kieran Poynter	2010	5/5
Karen de Segundo[2(b)]	2007–2016	2/2
Dr Richard Tubb[1(c),2(b)]	2013–2016	1/2

Notes:
1. Number of meetings in 2016: (a) the Committee held five meetings, three of which were convened at short notice; (b) Dimitri Panayotopoulos missed the April and July ad hoc meetings, arranged at short notice, due to injury and illness; and (c) Dr Richard Tubb missed the April ad hoc meeting, arranged at short notice, due to family illness.
2. Membership: (a) all members of the Committee are independent in accordance with Code Provision B.2.1.; (b) Karen de Segundo and Dr Richard Tubb ceased to be members of the Committee upon their retirement as Non-Executive Directors at the AGM on 27 April 2016; (c) Dr Marion Helmes became a member of the Committee on 1 August 2016 following her appointment as a Non-Executive Director; and (d) Christine Morin-Postel ceased to be a member of the Committee upon her retirement as a Non-Executive Director on 6 December 2016.
3. Other attendees: the Chief Executive, Group Human Resources Director and Group Head of Talent & Organisation Effectiveness regularly attend meetings by invitation but are not members.

For the Committee's terms of reference see
www.bat.com/governance

Role

The Nominations Committee is responsible for:

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

Key activities in 2016 – reviewing:

- Executive Directors' 2016 performance assessment;
- Directors' annual appointment and re-election at the AGM;
- the Nominations Committee effectiveness following the Board evaluation process;
- an update on the proposal to appoint a sub-Committee of the Board, comprising three Non-Executive Directors, to provide Board visibility and input to the investigation of certain allegations regarding historic misconduct in Africa as necessary, between the scheduled Board meetings;
- Non-Executive Director appointments, interviewing candidates and recommending appointments to the Board;
- the Group Talent Strategy and talent development priorities for 2016;
- succession planning for the Executive Directors and for the Management Board;
- the progress of bespoke development plans for high potential candidates for Executive Director and Management Board roles (covering the key experience required for further progression, mentoring and education opportunities);
- the progress of diversity initiatives;
- membership of the Company's primary Board Committees following the proposed removal of the CSR Committee with effect from 28 April 2016;
- updates on the status of the search for new Non-Executive Directors and recommending the appointment of Dr Marion Helmes;
- Board Committee appointments including recommending to the Board the appointment of Kieran Poynter as Chairman of the Audit Committee and Senior Independent Director (SID), with effect from 26 October 2016, to replace Christine Morin-Postel, who retired from the Board on 6 December 2016 having served over nine years on the Board;
- Management Board appointments, including recommending to the Board the appointment of Tadeu Marroco, Business Development Director, to the role of Director, Western Europe and of Naresh Sethi, Director, Western Europe to the role of Director, Business Development, both with effect from 1 December 2016; and
- recommending to the Board the appointment of Paul McCrory as Company Secretary with effect from 1 May 2017, to replace Nicola Snook, who will be retiring from the Company on 14 July 2017.

Terms of appointment to the Board

Details of the Directors' terms of appointment to the Board are contained in the Remuneration Policy which is set out in full on www.bat.com. The Executive Directors have rolling contracts of one year. The Non-Executive Directors do not have service contracts with the Company but instead have letters of appointment for one year. Their expected time commitment is 25–30 days per year. The Board considers the need for it to refresh its membership progressively over time. Non-Executive Directors are normally expected to serve for up to six years. They may be invited to serve for longer, but additional service beyond six years is subject to rigorous review and service beyond nine years is unlikely.

The Committee is responsible for identifying candidates for positions on the Board. This process includes an evaluation of the skills and experience to be looked for in candidates to ensure continuing Board balance and relevant experience. The selection process involves interviews with several candidates, using the services of specialist external search firms to identify and shortlist appropriate candidates. A balanced list including both genders is a requirement of any shortlist. This process was followed for the recruitment of Dr Marion Helmes, who was shortlisted by Egon Zehnder and interviewed by the Chairman, Executive Directors and members of the Committee, which then recommended her appointment to the Board.

Annual General Meeting 2017

Dr Gerry Murphy has indicated that he will be retiring from the Board at the end of this year's AGM on 26 April 2017, having served eight years on the Board. The Company will be submitting all other eligible Directors for re-election and, in the case of Dr Marion Helmes, election for the first time.

The Chairman's letter accompanying the AGM Notice confirms that all Directors being proposed for re-election are effective and that they continue to demonstrate commitment to their roles as Non-Executive Directors.

Remuneration Report

Annual Statement

Dimitri Panayotopoulos
Chairman of the Remuneration Committee

Dear Shareholder

Remuneration and strategy

As the new Chairman of the Remuneration Committee, I see it as essential that I build on the achievements of my predecessors to ensure that the Company continues to have in place an effective Remuneration Policy which: (1) enables it to attract and retain top quality talent in a global marketplace; (2) rewards high levels of sustainable long-term performance in an appropriate and competitive manner to the benefit of both shareholders and stakeholders; and (3) forges closer long-term links between the Company's senior management and its shareholders. Indeed, our recent experiences of working closely with our investors to successfully reshape our Remuneration Policy reflect these objectives and it is my role to ensure that this focus is maintained.

Shareholder engagement

The early part of 2016 was devoted to a detailed programme of engagement with investors on the remuneration proposals contained in the new Remuneration Policy which was subsequently given a positive endorsement at the AGM in April with its approval of that Policy and the accompanying new Long-Term Incentive Plan. It was very pleasing to note the 90% shareholder votes cast in favour of the new Policy. I would personally like to thank all those shareholders who worked with us and also supported these Policy changes together with our Annual Report on Remuneration. I would further add that post the AGM, much of the Committee's work during the remainder of the year has centred on overseeing the systematic implementation of that Policy.

The wider picture

The second half of 2016 has also seen a continuation of the debate on executive remuneration as exemplified by the launch of the Government's inquiry into business practices and corporate governance. This includes in its remit an examination of executive pay and the roles and responsibilities that both company boards and shareholders have to play. We have responded to the initial CBI feedback on this topic and have actively contributed to a number of roundtable discussions on the Green Paper, including the GC100 Conference: Corporate Governance, Business and Society. We look forward to further engagement once the Government's ideas and proposals have been formulated, being mindful of the need for transparency in disclosure of remuneration but with a positive emphasis on simplicity rather than on regulation which might be complex and burdensome to implement and open to interpretation and ambiguity which runs counter to the concept of transparency.

Outcomes 2016

The Group has delivered an outstanding set of results, building strongly on the long-term strategic growth agenda across all key business metrics. These results are reflected positively in the outcomes for the IEIS for which the corporate result across the four measures (Group share of Key Markets; Global Drive Brands and Key Strategic Brands volumes; adjusted profit from operations; and cash generated from operations) was 100%.

The 2014 LTIP awards with KPIs representing EPS, TSR and NTO will vest in March 2017 at 46.0%. These outcomes were achieved despite the strong impact of translational currency headwinds across our operations worldwide. Details of these IEIS and LTIP outcomes for the Executive Directors the year ended 2016 are given in the short-term incentives and long-term incentives sections of this report.

On 17 January 2017, the Group announced the agreement to acquire the remaining 57.8% of shares in Reynolds American that it does not already own, subject to regulatory and shareholder approvals. This transaction will create a truly global business with a world-class portfolio of tobacco and Next Generation Products which will be available across the most attractive markets in the world.

Looking forward 2017

On behalf of the Remuneration Committee, I acknowledge the scope of the tasks for the year ahead as we continue to embed our new Policy with an eye on the wider focus and debate on corporate reward outcomes for leading FTSE 100 companies.

Dimitri Panayotopoulos
Chairman, Remuneration Committee

22 February 2017

The following summary Policy Report and Annual Report on Remuneration have been prepared in accordance with the relevant provisions of the Companies Act 2006 and as prescribed in The Large and Medium-sized Companies and Group (Accounts and Reports) (Amendment) Regulations 2013 (the Regulations). Where required, data has been audited by KPMG LLP and this is indicated appropriately.

Summary

Our Remuneration Policy 2016

The Remuneration Policy for the Executive Directors and the Non-Executive Directors applicable in 2016 was approved by shareholders at the Annual General Meeting on 27 April 2016. It is set out in full in the Future Policy Table for Executive Directors and the Remuneration Table for the Chairman and Non-Executive Directors in the Remuneration Report 2015 contained in the Annual Report 2015 on www.bat.com.

We have summarised the key elements below to facilitate the understanding of the Annual Report on Remuneration 2016 (pages 56–76 of this Remuneration Report 2016) as set out below.

Our principles of remuneration – summary
The Committee's remuneration principles seek to reward the delivery of the Group's strategy in a simple and straightforward manner which is aligned to shareholders' long-term sustainable interests.
The remuneration structure comprises fixed and variable elements. These rewards are structured and designed to be both transparent and stretching while recognising the skills and experience of the Executive Directors and ensuring a market competitiveness for talent. The fixed elements comprise base salary, pension and other benefits; the variable elements are provided via two performance-based incentive schemes (a single cash and share incentive annual bonus plan (IEIS), and a single long-term incentive scheme (LTIP)).
In applying these principles, the Committee maintains an appropriate balance between fixed pay and the opportunity to earn performance-related remuneration with the performance-based elements forming, at maximum opportunity, between 75% and 85% of the Executive Directors' total remuneration. An annual review is conducted to ensure application and alignment of the Policy with the business needs to promote the long-term success of the Company.

How each key element of our remuneration supports the strategic priorities	
Fixed remuneration: base salary pension benefits	– attract and retain high calibre individuals to deliver the Company's strategic plans by offering market competitive levels of guaranteed **cash** to reflect an individual's skills, experience and role within the Company; – provide competitive **post-retirement benefit arrangements** which recognise both the individual's length of tenure with the Group and the external environment in the context of attracting and retaining senior high calibre individuals to deliver the Group's strategy; and – provide market competitive **benefits** consistent with role which: (1) help to facilitate the attraction and retention of high calibre, senior individuals to deliver the Company's strategic plans; and (2) recognise that such talent is global in source and that the availability of certain benefits (e.g. relocation, repatriation, taxation compliance advice) will from time to time be necessary to avoid such factors being an inhibitor to accepting the role.
Variable remuneration: short-term incentives	– incentivise the attainment of corporate targets aligned to the strategic objectives of the Company on an annual basis; – performance-based award in the form of **cash and deferred shares**, so that the latter element ensures alignment with shareholders' long-term interests; – strong alignment and linkage between individual and corporate annual objectives via the application of an individual performance adjustment factor to the corporate result; and – ensure, overall, a market-competitive package to attract and retain high calibre individuals to deliver the Group's strategy.
Variable remuneration: long-term incentives	– incentivise long-term sustainable growth in **total shareholder return (TSR), adjusted diluted earnings per share (EPS) and net turnover (NTO)**, together with the achievement of a consistently high measure of **operating cash flow to operating profit conversion ratio** over a three-year period; to facilitate the appointment of high calibre, senior individuals required to deliver the Company's strategic plans; and to promote the long-term success of the Company; and – to put in place a combination of measures with appropriately stretching targets around the long-term plan that provides a balance relevant to the Company's business and market conditions, as well as providing alignment between Executive Directors and shareholders. In setting performance criteria and thresholds/targets, the Committee takes account of the Group's long-term plans and market expectations.

Remuneration Report

Summary continued
Our Remuneration Policy 2016

Fixed remuneration – Executive Directors

Base salary	Base salary is normally paid in 12 equal monthly instalments during the year and is pensionable.
Increases in salary will generally be in the range of the increases in the base pay of other UK-based employees in the Group.	Salaries are normally reviewed annually in February (with salary changes effective from April) or subject to an ad hoc review on a significant change of responsibilities.
The salary of a recently appointed Executive Director as he or she progresses in a role may exceed the top of the range of the salary increases for UK-based employees where the Committee considers it appropriate to reflect the accrual of experience.	Salaries are reviewed against appropriate market data, including general UK pay trends and a company size and complexity model based on UK companies, as well as a Pay Comparator Group, the constituents of which at the date of this report for use in 2017 are set out below.
Year-on-year increases for Executive Directors, currently in role, will not exceed 10% per annum during the policy period.	
A significant change in responsibilities may be reflected in an above-average increase (which may exceed 10%) of salary.	
Promotion leading to a complete change of role would be considered in line with the Committee's approach to recruitment.	

Pay Comparator Group	
Anheuser-Busch InBev	Kellogg
AstraZeneca	Kraft-Heinz
Bayer	L'Oréal
BP	LVMH
BT	Mondelēz International
Coca-Cola	Nestlé
Colgate-Palmolive	PepsiCo
Danone	Pernod Ricard
Diageo	Philip Morris International
GlaxoSmithKline	Procter & Gamble
Heineken	Reckitt Benckiser
Imperial Brands	Royal Dutch Shell
Japan Tobacco International	Unilever
Johnson & Johnson	Vodafone

The Committee will continue to exercise its judgement to vary the constituents of the Pay Comparator Group over the life of this Remuneration Policy.

Fixed remuneration – Executive Directors

Pension British American Tobacco UK Pension Fund (Pension Fund) Unfunded unapproved retirement benefit scheme (UURBS)	– pensionable pay covers base salary only; – internal appointees as Executive Directors may have existing defined benefit or defined contribution pension entitlements with the Group which may differ marginally from those outlined in the Policy and these will ordinarily remain unchanged; and – pension entitlements for external appointees as Executive Directors will be subject to negotiation taking into account the relevant annual and lifetime allowances; in most cases the pension arrangements will fall within the scope of the Policy.
Pension Fund: non-contributory defined benefit section	– accrual rates differ according to individual circumstances but do not exceed 1/40th of pensionable salary for each year of pensionable service; – retains a scheme-specific salary cap (currently £151,200 effective 1 April 2016); – benefits in excess of the cap are accrued in the UURBS; and – defined benefit section closed to new members generally – the Remuneration Committee may exercise its judgement to offer, by exception a defined benefit pension to a new externally appointed Executive Director (on appointment where such benefits have been enjoyed by that individual at his/her previous employment).
Pension Fund: defined contribution section	– in place since April 2005; – annual contribution up to the equivalent of 35% of base salary would be made; – actual level of contribution paid to the Pension Fund is restricted to take account of the annual allowance and lifetime allowance; and – balance of contribution payable as a gross cash allowance or accumulated in the UURBS.
UURBS	– accrued defined benefits in the UURBS may be received on retirement either as a single lump sum or as an ongoing pension payment; and – pension accrual in the UURBS is at the same rate as in the Pension Fund (1/40th per annum).

Fixed remuneration – Executive Directors	
Benefits With the exception of the car or car allowance, in line with the UK market and the practice followed for all the Group's other UK employees, it is also practice to pay the tax that may be due on these benefits.	The Company currently offers the following range of contractual benefits to Executive Directors (on an individually specific basis) with maximum annual values (subject to periodic inflation-related increases where applicable): – **car or car allowance:** £20,000; – **use of a company driver:** variable maxima as the actual cost is dependent on the miles driven in any year; – variable maxima will apply to the cost of **private medical insurance** which is dependent on an individual's circumstances and is provided on a family basis; – **GP 'walk-in' medical services located close to the Group's headquarters in London:** £5,000 per annum; – **personal life and accident insurance** designed to pay out at a multiple of four and five times base salary respectively; – **international tax advice** as required, but not exceeding £30,000 per annum and **tax equalisation payments** as agreed by the Committee from time to time; and – **relocation and shipment expenses** at the beginning and end of service as an Executive Director up to £200,000 and, in addition, **housing and education allowances** or other similar arrangements, as appropriate to the individual's family circumstances.

Variable remuneration	Executive Directors			
Short-term incentives – IEIS	**Chief Executive**		**Finance Director**	
IEIS opportunity **50% cash; 50% deferred shares (DSBS)** **Percentage of base salary**	**Maximum**	**On-target**	**Maximum**	**On-target**
	250%	**125%**	**190%**	**95%**
IEIS – performance adjustment and clawback and malus	**Performance adjustment factor:** up to **20% uplift** possible if individual performance is assessed as outstanding (up to the maximum opportunity of 250% or 190%). Up to **50% reduction** possible if individual performance is assessed as poor. **Clawback and malus**: provisions are in place.			

IEIS – performance measures and weighting (%)	Measures	Weighting
Two levels of award attainment relative to the measures are defined under the IEIS	**Adjusted profit from operations:** profit from operations of the Group's subsidiaries at constant rates of exchange as adjusted for the items shown as memorandum information in the Group Income Statement.	40%
Threshold – This must be exceeded to attract any bonus pay-out in respect of that measure.	**Group's share of Key Markets:** the Group's retail market share in its Key Markets, which accounts for around 80% of the volumes of the Group's subsidiaries.	20%
Maximum – A level of performance exceeding budget and at which the bonus pay-out for that measure is capped.	**Global Drive Brands (GDBs) and Key Strategic Brands (KSBs) volumes:** comprises: (1) the GDB cigarette volumes: Dunhill, Kent, Lucky Strike, Pall Mall and Rothmans, including volumes of the Fine Cut variants of the above brands sold in Western Europe; and (2) the cigarette volumes of State Express 555 and Shuang Xi, being KSBs associated with the CNTC joint venture.	20%
	Cash generated from operations: the free cash flow excluding restructuring costs, dividends and other appropriations from associate undertakings measured at constant rates of exchange.	20%

Long-term incentives – LTIP	Chief Executive			Finance Director		
LTIP opportunity: shares to a percentage value of base salary at time of award	**Awards**	**2016**	**2014 and 2015**	**Awards**	**2016**	**2014 and 2015**
	Maximum	500%	400%	Maximum	350%	300%
Dividend equivalent payment **Clawback and malus**	**Dividend equivalent payment:** on all vesting shares. **Clawback and malus:** provisions are in place.					
LTIP Extended Vesting Period: 2016 awards onwards	An additional vesting period of two years applies from the third anniversary of the date of grant. LTIP awards vest only to the extent that: (1) the performance conditions are satisfied at the end of the three-year performance period; and (2) an additional vesting period of two years from the third anniversary of grant is completed.					

Summary continued

Our Remuneration Policy 2016

LTIP performance measures	LTIP Awards 2016
Performance measures – calculations Details of the calculation and application of: TSR; EPS (at current and constant rates of exchange); NTO and the operating cash flow conversion ratio are set out in the Future Policy Table for Executive Directors in Remuneration Report 2015 contained in the Annual Report 2015 on www.bat.com.	

LTIP measures and performance ranges	% of award	Threshold vesting %
1. **Total shareholder return (TSR) relative to global FMCG peers** Median performance vs. FMCG peer group to upper quartile. The current constituents of the FMCG peer group as at the date of this report are:	20	3
2. **Growth in adjusted earnings per share (EPS) at current exchange rates** 5%–10% CAGR over the performance period	20	3
3. **Growth in adjusted earnings per share (EPS) at constant exchange rates** 5%–10% CAGR over the performance period	20	3
4. **Growth in net turnover (NTO)** 3%–5% CAGR over the performance period	20	3
5. **Operating cash flow as a % of adjusted operating profit (AOP)** Cash flow is 85%–95% of AOP over the performance period	20	3
Total	**100**	**15**

FMCG peer group:

Anheuser-Busch InBev	Diageo	Kimberly Clark	Philip Morris International
Campbell Soup	Heineken	LVMH	Procter & Gamble
Carlsberg	Imperial Brands	Mondelēz International	Reckitt Benckiser
Coca-Cola	Japan Tobacco	Nestlé	Unilever
Colgate-Palmolive	Johnson & Johnson	PepsiCo	
Danone	Kellogg	Pernod Ricard	

Other elements of remuneration	
All-employee share schemes	Executive Directors are eligible to participate in the Company's all-employee share schemes. **Sharesave Scheme** – an HMRC-approved scheme where eligible employees are granted savings-related share options to subscribe for ordinary shares in the Company. **Share Incentive Plan (SIP)** – an HMRC-approved plan incorporating: (1) Partnership Scheme and (2) Share Reward Scheme.
Shareholding requirements	Shares awarded but not yet vested and for which performance conditions have already been met under the DSBS element of the IEIS are included in the calculation of the threshold for the shareholding guidelines for the Executive Directors. The estimated notional net number of shares held by an Executive Director in the LTIP Extended Vesting Period will also count towards the respective shareholding requirements.
External Board appointments	Each Executive Director is limited to one external appointment, with the permission of the Board. Any fees from such appointments are retained by the individual in recognition of the increased level of personal commitment required.

Chief Executive	Finance Director
% of salary	% of salary
500	350

Other policy provisions in relation to Directors' pay

Flexibility, judgement and discretion

As the Company's Remuneration Policy needs to be capable of operating over a three-year period, the Committee requires practical tools to implement the Policy over that prospective lifetime and so has built in degrees of adaptability under the categories of flexibility, judgement and discretion.

Category	Basic description Further details are set out in the Future Policy Table for Executive Directors in Remuneration Report 2015 contained in the Annual Report 2015 on www.bat.com.
Flexibility	Those areas of the Policy which include a degree of flexibility with reference to specific examples and situations regarding pay, benefits and pension arrangements, the IEIS bonus plan and the LTIP.
Judgement	Examples when the Committee will be required to exercise its judgement over the life of the Policy in considering, assessing and determining items such as specific levels, measures, weightings, performances and percentages across the fixed and variable remuneration.
Discretion	Instances where the Committee has reserved discretion which may be exercised either upwards or downwards (to ensure fair outcomes for both Directors and shareholders) notwithstanding the application of the Policy in certain instances. Whenever the Committee exercises its discretion in relation to an Executive Director, it will disclose the rationale for doing so in its Annual Report on Remuneration the following year.

Approach to remuneration of Directors on recruitment

Factor/Event	Basic description Further details are set out in the Future Policy Table for Executive Directors in Remuneration Report 2015 contained in the Annual Report 2015 on www.bat.com.
Principles	In making an Executive Director appointment (whether an internal or external appointee) the Remuneration Committee will follow a set of principles based on those summarised under 'Our principles of remuneration' set out on page 49.
External appointment to role of Executive Director	Where the individual has variable remuneration arrangements with his or her previous employer that will be lost on joining British American Tobacco.
Relocation – to the UK from overseas and return on retirement or departure from the Group	British American Tobacco may provide appropriate relocation support across specified categories.

Summary continued

Our Remuneration Policy 2016

Service contracts – Executive Directors

Factor/Event	Basic description
	Further details are set out in the Future Policy Table for Executive Directors in Remuneration Report 2015 contained in the Annual Report 2015 on www.bat.com.
Current Executive Directors	Employed on a one-year rolling contract, executed at the time of the original appointment. The Remuneration Committee may exercise its discretion to award two- or three-year contracts in the event that an Executive Director is recruited externally or from overseas; contracts with an initial period of longer than one year will then reduce to a one-year rolling contract after the expiry of the initial period.
Under the current contracts British American Tobacco has agreed to certain described obligations, any of which could give rise to, or impact upon, the remuneration or payments for loss of office	It is not currently intended that future service contracts for Executive Directors would contain terms differing materially from the Policy.
Inspection of service contracts	Copies may be inspected at the Company's registered office; these contracts are amended annually following the salary review. The dates of the latest service contracts are shown below:

Executive Directors	Execution date of current service contract
Nicandro Durante	10 December 2010
Ben Stevens[1]	26 March 2008

1 Contract as amended by a side letter dated 23 July 2010.

Policy on payment for loss of office

Factor/Event	Basic description
	Further details are set out in the Future Policy Table for Executive Directors in Remuneration Report 2015 contained in the Annual Report 2015 on www.bat.com.
Principles	The principles on which the Remuneration Committee will approach the determination for payments on termination are as follows: compensation for loss of office in service contracts is limited to no more than 12 months' salary and benefits excluding pension; in the event that the contract is terminated for cause (such as gross misconduct), the Company may terminate the contract with immediate effect and no compensation would be payable; and the service contracts of the Executive Directors are terminable on the expiry of twelve months' notice from either the Director or the Company – which means that, where an internal successor has not been identified, the Company would have sufficient time to replace the Executive Director through an orderly external recruitment process and ideally have a period of handover.
Treatment of awards under the share incentive schemes: International Executive Incentive Scheme (IEIS)/ Deferred Share Bonus Scheme (DSBS) Long-Term Incentive Plan (LTIP) All-employee scheme: Share Reward Scheme (SRS)	Executive Directors do not have contractual rights to the value inherent in any awards held under the share incentive schemes. The release of awards is dependent on 'leaver' status and is at the discretion of the Committee. The Remuneration Committee retains discretion in deciding 'good leaver' status other than in cases of automatic 'good leavers' as set out in the applicable provisions of the DSBS and LTIP rules. The discretionary powers are intended to provide flexibility as Executive Directors may leave employment for a broad variety of reasons which may not necessarily fall within the prescribed category of 'good leaver'. The Committee exercises its discretion by reference to guidelines which set out its agreed relevant factors to assist in the determination of a leaver's status. In exercising its discretion, the Committee will also take into account the individual's overall performance as well as their contribution to the Company during their total period of employment. Details of how leavers are assessed as 'good leavers' are set in the Policy.
Other discretionary powers	The Remuneration Committee retains discretion to settle any other amounts reasonably due to an individual Executive Director as specified in the Policy. In certain circumstances, the Committee may approve new contractual arrangements with departing Executive Directors, potentially including (but not limited to) settlement, confidentiality, restrictive covenants and/or consultancy arrangements; these arrangements would only be entered into where the Committee believes that it is in the best interests of the Company and its shareholders to do so.

Chairman and Non-Executive Directors

	Chairman
Fee	– considered annually by the Remuneration Committee using data from the FTSE 30 companies and taking into account the breadth of that role, coupled with its associated levels of personal commitment and expertise in the overall context of international reach and the 'ambassadorial' aspect of the role; – the Chairman is currently expected to make an annual time commitment of about 100 days; and – he does not participate in any discussions on his level of remuneration.
Benefits, travel and related expenses	– reimbursed for the cost of travel and related expenses incurred by him in respect of attendance at Board, Committee and general Meetings including the cost of return airline tickets to London from his home in Ireland in connection with his duties as Chairman; – entitled to the use of a Company driver; private medical insurance and personal accident insurance benefits; the provision of home and personal security; and general practitioner 'walk-in' medical services based a short distance from the Company's Group headquarters in London; – Richard Burrows' spouse may, from time to time, accompany him to participate in a partners' programme occasionally organised in conjunction with overseas or UK-based Board meetings and otherwise at hospitality functions during the year; and – when considering the appointment of a new Chairman, the Remuneration Committee will offer the components set out in respect of the current Chairman, as appropriate, and may also offer housing allowances for a limited period and other relocation benefits.
	Non-Executive Directors
Fees It is anticipated that any future aggregate increase to any of the fees for the Chairman and Non-Executive Directors will be within the salary range which governs the Company's annual salary reviews for UK-based staff and will not exceed the equivalent of 10% per annum in aggregate.	– Non-Executive Directors receive a base fee and an appropriate Board Committee Membership Fee. The Chairs of the Audit and Remuneration Committees receive an additional supplement and an additional supplement is also paid to the Senior Independent Director; – quantum and structure of Non-Executive Directors' remuneration primarily assessed against the same Pay Comparator Group of companies used for setting the remuneration of Executive Directors; the Board may also make reference to and take account of relevant research and analysis on Non-Executive Directors' fees in FTSE 100 companies published by remuneration consultants from time to time; – fees for the Non-Executive Directors are reviewed annually, usually in April; the review does not always result in an increase in the Board fees or Committee fees; and – the Board as a whole considers the policy and structure for the Non-Executive Directors' fees on the recommendation of the Chairman and the Chief Executive; Non-Executive Directors do not participate in discussions on their specific levels of remuneration.
Travel and related expenses In instances where any reimbursements or expenses are classified by HMRC as a benefit to the Director, it is also the practice of the Company to pay any tax due on any such benefits.	– Non-Executive Directors are generally reimbursed for the cost of travel and related expenses incurred by them in respect of attendance at Board, Committee and General Meetings; – it is Board policy that the partners of the Non-Executive Directors may, from time to time, accompany the Directors to participate in a partners' programme occasionally organised in conjunction with overseas or UK-based Board meetings and otherwise at hospitality functions during the year; and – Non-Executive Directors are also eligible for general practitioner 'walk-in' medical services based a short distance from the Company's Group headquarters in London; Non-Executive Directors receive no other benefits.
Shareholding requirements	– remuneration of the Chairman and the Non-Executive Directors is paid in cash; and – no formal requirements or guidelines to hold shares in the Company; neither the Chairman nor the Non-Executive Directors participate in the British American Tobacco share schemes, bonus schemes or incentive plans and they are not members of any Group pension plan.

Annual Report on Remuneration

Dimitri Panayotopoulos
Chairman of the Remuneration Committee

Remuneration Committee current members
Dimitri Panayotopoulos (Chairman)
Sue Farr
Ann Godbehere
Savio Kwan

Attendance at meetings in 2016

Name	Member since	Attendance/ Eligible to attend
Sue Farr[2(b)]	2016	3/3
Ann Godbehere	2011	5/5
Savio Kwan[2(b)]	2016	3/3
Christine Morin-Postel[2(c)]	2007–2016	2/2
Dimitri Panayotopoulos[2(e)]	2015	5/5
Kieran Poynter[2(d)]	2011–2016	3/3

Notes:

1. **Number of meetings 2016:** the Committee held five meetings, one of which was convened at short notice.
2. **Membership:** (a) all members of the Committee are independent Non-Executive Directors in accordance with Code Provision D.2.1.; (b) Sue Farr and Savio Kwan joined the Committee on 28 April 2016; (c) Christine Morin-Postel ceased to be a member on 28 April 2016; (d) Kieran Poynter stood down as Chairman and ceased to be a member on 1 October 2016; and (e) Dimitri Panayotopoulos became Chairman on 1 October 2016, having been a member since 2 February 2015.
3. **Other attendees:** the Chairman, the Chief Executive, the Group Human Resources Director, the Group Head of Reward and other senior management, including the Company Secretary, may be consulted and provide advice, guidance and assistance to the Committee. They may also attend Committee meetings (or parts thereof) by invitation; neither the Chairman nor any Executive Director plays any part in determining their own remuneration.
4. **Deloitte LLP:** as the Committee's remuneration consultants, they may attend meetings of the Committee. As a member of the Remuneration Consultants Group (RCG), Deloitte agrees to the RCG Code of Conduct which seeks to clarify the scope and conduct of the role of executive remuneration consultants when advising UK-listed companies.

For the Committee's terms of reference see
www.bat.com/governance

This section sets out the remuneration of the Directors for the financial year ended 31 December 2016.

Role

The Remuneration Committee is responsible for:

– agreeing and proposing the Remuneration Policy for Directors (covering salary, benefits, performance-based variable rewards and pensions) for shareholder approval;

– determining, within the terms of the agreed Policy, the specific remuneration packages for the Chairman and the Executive Directors, both on appointment and on review and, if appropriate, any compensation payment due on termination of appointment;

– the setting of targets applicable for the Company's performance-based variable reward scheme and determining achievement against those targets, exercising discretion where appropriate and as provided by the applicable scheme rules and the Policy; and

– monitoring and advising the Board on any major changes to the policy on employee benefit structures for the Group.

Remuneration Committee – advisers during 2016

Independent external advisers	Services provided to the Committee	Fees	Other services provided to the Company
Deloitte LLP	General advice on remuneration matters including: market trends and comparator group analysis; policy review and shareholder engagement perspectives; and independent measurement of TSR performance conditions.	2016: £89,050 2015: £178,750	Up to February 2016, specified procedures to assist in the assessment of the calculations of the IEIS bonus outcomes and future targets. This service is now provided by KPMG LLP.
Herbert Smith Freehills LLP	Advice in respect of share plan regulations is provided to the Company and is available to the Committee.	Fees relate to advice given to Company	General corporate legal and tax advice principally in the UK.
Ernst & Young LLP	Provision of personal tax advice regarding Executive Directors' international pension planning.	Fees relate to advice given to Company	Tax, corporate finance and consulting services to Group companies worldwide.
KPMG LLP	Specified procedures to assist in the assessment of the calculations of the IEIS bonus outcomes and future targets.	2016: £15,000 2015: n/a	Audit and tax services and other non-audit services. External auditor from 27 March 2015.

Remuneration Committee – activities in 2016

Regular work programme

- reviewed salaries for the Executive Directors from 1 April 2016 taking into account both the Pay Comparator Group positioning and the pay and employment conditions elsewhere in the Group, particularly in the UK, resulting in a 0% increase;
- reviewed the Chairman's fee from 1 April 2016, resulting in a 0% increase;
- assessed the achievement against the targets for the 2015 IEIS award and set the IEIS targets for 2016;
- assessed and agreed that no award of an individual performance element for the Executive Directors was appropriate for 2015 as the IEIS payout was at the maximum level;
- assessed the achievement against the performance conditions for the vesting of the LTIP 2013 award, determined the contingent level of LTIP awards for May 2016 under the new LTIP and confirmed the associated performance conditions;
- assessed the achievement against the targets for the 2015 Share Reward Scheme and set the targets for the 2016 award;
- monitored the continued application of the Company's shareholding guidelines for the Executive Directors;
- reviewed the Annual Statement, the Policy Report and the Annual Report on Remuneration for the year ended 31 December 2015 prior to its approval by the Board and subsequent shareholder submission to the AGM on 27 April 2016;
- analysed the AGM 2016 results on remuneration voting and reviewed market trends in the context of that AGM season;
- reviewed the salary and incentives market data and current trends for Executive Directors;
- reviewed the achievement against the performance measures for the six months to 30 June 2016 for the IEIS 2016 and the outstanding LTIP awards;
- approved a rebasing of the notional Brazilian salary (with effect from 1 April 2015) in respect of the application of that element to the UURBS pension entitlement of the Chief Executive;
- previewed the positioning of the salaries for Executive Directors for 2017; and
- reviewed the report on the effectiveness of the Remuneration Committee.

Annual Report on Remuneration continued

Remuneration policy matters

– discussed the outcomes of the consultation with major investors in respect of the proposed changes to the Remuneration Policy;

– agreed and approved the rules of the new Long-Term Incentive Plan (subject to approval by shareholders at the AGM) which included: (1) two new performance measures: (a) EPS at constant rates of exchange; and (b) cash flow conversion; (2) an increased maximum award level (500% of salary); (3) value of vesting award for threshold performance reduced from 20% to 15% of the award; and (4) the introduction of an additional period of two years after the three-year performance period so that vesting may take place no earlier than five years from the date of grant of an award;

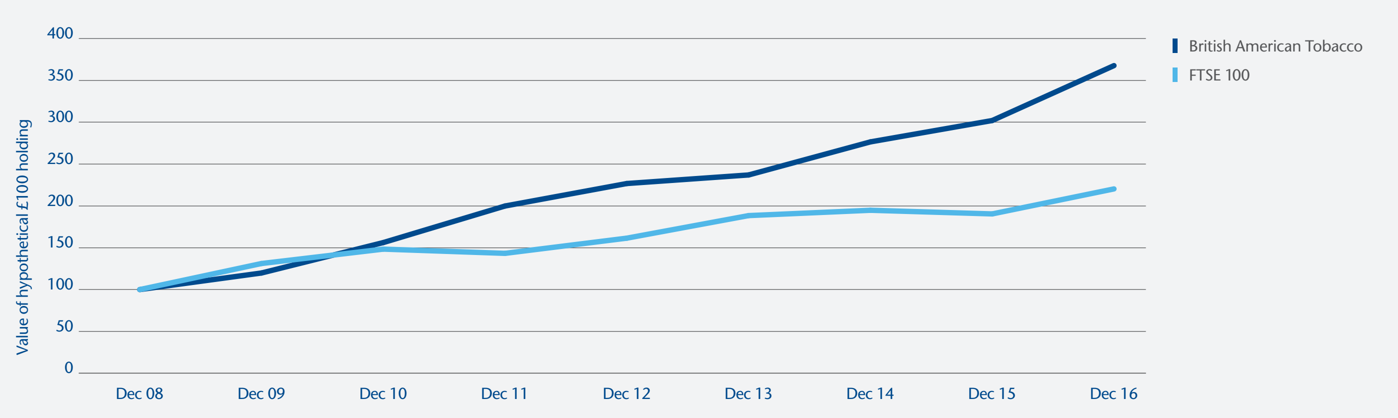
– agreed and approved the rules of a new Sharesave Scheme to replace the current Sharesave Scheme for all employees due to expire in 2017; and

– finalised the content of the new Remuneration Policy to be put to shareholders at the AGM on 27 April 2016.

Other incentive matter

– noted the Company's proposals in respect of the reduction in the tax allowances available for pension contributions in the UK for senior managers, together with the related programme of consultation with affected employees.

Total shareholder return (TSR) performance: 1 January 2009 to 31 December 2016



Notes:
1. **Performance and pay chart:** this shows the performance of a hypothetical investment of £100 in the Company's shares (as measured by the TSR for the Company) against a broad equity market index (the FTSE 100 Index) over a period of eight financial years starting from 1 January 2009 through to 31 December 2016 based on 30-trading-day average values.
2. **TSR:** this is measured according to the return index calculated by Datastream and has been reviewed by the Committee's remuneration consultants. It is measured on the basis that all the Company's dividends are reinvested in the Company's shares. The return is the percentage increase in the Company's index over the eight-year period. A local currency basis is used for the purposes of the TSR calculation making it consistent with the approach to TSR measurement for the LTIP.

Chief Executive's (CEO) pay – comparative figures 2009 to 2016

Year	2009	2010	2011	2012	2013	2014	2015	2016
CEO 'single figure' of total remuneration (£'000)								
Paul Adams[1] (to 28 February 2011)	7,713	8,858	5,961	n/a	n/a	n/a	n/a	**n/a**
Nicandro Durante[2] (from 1 March 2011)	n/a	n/a	5,589	6,340	6,674	3,617	4,543*	**7,630**
Annual bonus (IEIS) paid against maximum opportunity (%)								
Paul Adams[1] (to 28 February 2011)	67.7	87.0	100	n/a	n/a	n/a	n/a	**n/a**
Nicandro Durante[2] (from 1 March 2011)	n/a	n/a	100	85.0	81.3	73.2	100	**100**
Long-term incentive (LTIP) paid against maximum opportunity (%)								
Paul Adams[1] (to 28 February 2011)	100	100	100	n/a	n/a	n/a	n/a	**n/a**
Nicandro Durante[2] (from 1 March 2011)	n/a	n/a	100	87.1	49.2	00.0	8.7	**46.0**

Notes:

1. **Paul Adams:** (a) historic data is taken from the Remuneration Reports for the relevant years and is recast (as appropriate) on the basis of the 'single figure' calculation as prescribed in the Regulations; (b) he retired as Chief Executive on 28 February 2011 which affected his short-term (annual bonus – IEIS) and long-term incentives (LTIP) as follows in accordance with the rules of those schemes: (i) his performance-related bonus (IEIS) for the year ended 31 December 2010 was paid as a 100% cash bonus instead of 50% in cash and 50% in deferred shares; (ii) the outstanding LTIP awards of shares vested immediately on his retirement either in full (2008 Award) or on a time-apportioned basis (2009 Award and 2010 Award); and (iii) the LTIP dividend equivalent payments for the LTIP awards which vested at his retirement were also paid in full and/or on a pro-rated time and performance basis.
2. **Nicandro Durante:** (a) historic data is taken from the Remuneration Reports for the relevant years and is recast (as appropriate) on the basis of the 'single figure' calculation as prescribed in the Regulations; (b) he became Chief Executive on 1 March 2011 and his 'single figure' remuneration for the year ended 31 December 2011 has accordingly been time-apportioned.

* **Long-term incentives 2015:** in accordance with the Regulations, estimates for the values of the vesting 2013 LTIP awards were given in the Annual Report on Remuneration 2015; these amounts have been re-presented to show the actual market value on the dates of exercise in 2016.

Relative importance of spend on pay

To illustrate the relative importance of the remuneration of the Directors in the context of the Group's finances overall, the Remuneration Committee makes the following disclosure:

Item	2016 £m	2015 £m	% change
Remuneration of Group employees[1]	**2,274**	2,039	12
Remuneration of Executive Directors	**12**	8	50
Remuneration of Chairman and Non-Executive Directors	**2**	2	–
Dividends paid in the year	**2,910**	2,770	5
Adjusted profit from operations[2]	**5,197**	4,992	4

Notes:

1. **Total remuneration of Group employees:** the increase is principally the result of translational foreign exchange movements and one-off adjusting items associated with various reorganisation activities undertaken with the Group during 2016.
2. **Adjusted profit from operations:** this is the adjusted profit from operations of the Group's subsidiaries at constant rates of exchange for the items shown as memorandum information in the Group Income Statement. It has been chosen as a benchmark for this disclosure given its linkage to the short-term incentive element of remuneration as one of the four performance measures under the IEIS.

Directors' remuneration for the year ended 31 December 2016

'Single figure' table for Executive Directors' remuneration: aggregate – audited

The following table shows a single figure of remuneration for the Executive Directors in respect of qualifying services for the year ended 31 December 2016 together with comparative figures for 2015. The aggregate Directors' emoluments are shown on page 70. Details of the fees for the Chairman and the Non-Executive Directors are set out in separate tables later in this report.

Single figure for Executive Directors	Salary £'000		Taxable benefits £'000		Short-term incentives £'000		Long-term incentives[1] £'000		Pension £'000		Other emoluments[2] £'000		Total £'000	
	2016	2015	**2016**	2015	**2016**	2015	**2016**	2015*	**2016**	2015	**2016**	2015	**2016**	2015
Nicandro Durante	**1,190**	1,181	**235**	155	**2,975**	2,380	**2,879**	414	**325**	392	**26**	21	**7,630**	4,543*
Ben Stevens	**867**	861	**100**	104	**1,647**	1,560	**1,604**	233	**309**	544	**18**	30	**4,545**	3,332
Total remuneration	**2,057**	2,042	**335**	259	**4,622**	3,940	**4,483**	647	**634**	936	**44**	51	**12,175**	7,875

Notes:

1. **Long-term incentives:** these include cash dividend equivalent payments made under the LTIP.
2. **Other emoluments:** include (1) life insurance; and (2) the value of shares received under the Share Reward Scheme during the year.

* **Long-term incentives 2015:** in accordance with the Regulations, estimates for the values of the vesting 2013 LTIP awards were given in the Annual Report on Remuneration 2015; these amounts have been re-presented to show the actual market value on the dates of exercise in 2016.

Annual Report on Remuneration continued

Analysis by individual Director – audited
Nicandro Durante

	2016 £'000	2015 £'000
Salary[1]	**1,190**	1,181
Taxable benefits		
Cash		
– car allowance	**16**	16
Non-cash		
– health insurance/provision of 'walk-in' health services	**8**	8
– tax advice	**28**	20
– the use of a company driver	**68**	59
– home and personal security in the UK and Brazil[3]	**109**	35
– other expenses incurred in connection with individual and/or accompanied attendance at certain business functions and/or corporate events	**6**	17
Total taxable benefits[2]	**235**	155
Short-term incentives		
IEIS: annual performance-related bonus – cash receivable March 2017 (YE 2016); cash received March 2016 (YE 2015)	**1,487.5**	1,190
DSBS: annual performance-related bonus – award of deferred shares at full market value March 2017 (YE 2016) and March 2016 (YE 2015)[4]	**1,487.5**	1,190
IEIS: no award of individual performance uplift for YE 2016 and YE 2015	**–**	–
Total short-term incentives	**2,975**	2,380
Long-term incentives		
LTIP: award 28 March 2014 of 135,052 shares; performance period 2014/2016; award will vest on 28 March 2017 at 46.0% resulting in 62,123 shares; estimated value shown for the purposes of this disclosure based on the average share price for the last three months for the year ended 31 December 2016 of 4,561.10p	**2,833**	
LTIP: award 22 March 2013 of 119,828 shares; performance period 2013/2015; award vested 22 March 2016 at 8.7% resulting in 10,425 shares; the award was exercised on 22 March 2016 at an execution price of 3,973.50p per share[5]		414
LTIP: cash dividend equivalent – a cash sum equivalent to the aggregated dividends that an LTIP participant would have received as a shareholder over the three-year period on the actual number of shares that vest under an LTIP award; 2016: (LTIP award 22 March 2013; vested at 8.7% on 22 March 2016); 2015: (LTIP award 28 March 2012; vested at 00.0% on 28 March 2015)	**46**	–
Total long-term incentives	**2,879**	414
Pension-related benefits		
Unfunded unapproved retirement benefit scheme (UURBS – UK)[6]	**325**	392
Total pension-related benefits	**325**	392
Other emoluments		
Life insurance	**22**	19
Share Reward Scheme: value of shares received during the year	**4**	2
Total other emoluments	**26**	21
Total remuneration	**7,630**	4,543

Notes:
1. **Salary:** base salary from 1 April 2016: £1,190,000 (+0%) (from 1 April 2015: £1,190,000); UK-based employees received salary increases averaging around 3% and within a range of 0% to 8% with effect from 1 April 2016.
2. **Benefits:** the figures shown are gross amounts as in line with the UK market; it is the normal practice of the Company to pay the tax which may be due on any benefits, with the exception of the car or car allowance.
3. **Security:** includes the installation and maintenance of enhanced additional home and personal security arrangements in Brazil to reflect the current security profile in that country.
4. **DSBS:** an award of deferred shares attracts a payment of a cash sum equivalent to the dividend on the after-tax position on all unvested ordinary shares comprised in the share award held by the participant at each dividend record date and paid on or after the relevant dividend payment date.
5. **LTIP:** award 22 March 2013: an estimated value of £394,000 was disclosed in the Annual Report on Remuneration for the year ended 31 December 2015; these amounts have been re-presented to show the actual market value on the dates of exercise in 2016.
6. **UURBS pension-related benefits:** these represent the net accrual for the period, being the differential between the individual's total pension entitlements as at 31 December 2015 (adjusted for inflation) and as at 31 December 2016, multiplied by 20 in accordance with the Regulations.
7. **External directorship:** Nicandro Durante is a non-executive director of Reckitt Benckiser Group. He retains the fees for this appointment, 2016: £110,000 (2015: £102,500).

Analysis by individual Director – audited

Ben Stevens

	2016 £'000	2015 £'000
Salary[1]	**867**	861
Taxable benefits		
Cash		
– car allowance	**14**	14
Non-cash		
– health insurance/provision of 'walk-in' health services	**8**	8
– the use of a company driver	**73**	76
– home and personal security in the UK	**3**	3
– other expenses incurred in connection with individual and/or accompanied attendance at certain business functions and/or corporate events	**2**	3
Total taxable benefits[2]	**100**	104
Short-term incentives		
IEIS: annual performance-related bonus – cash receivable March 2017 (YE 2016); cash received March 2016 (YE 2015)	**823.5**	780
DSBS: annual performance-related bonus – award of deferred shares at full market value March 2017 (YE 2016) and March 2016 (YE 2015)[3]	**823.5**	780
IEIS: no award of individual performance uplift for YE 2016 and YE 2015	**–**	–
Total short-term incentives	**1,647**	1,560
Long-term incentives		
LTIP: award 28 March 2014 of 75,230 shares; performance period 2014/2016; award will vest on 28 March 2017 at 46.0% resulting in 34,605 shares; estimated value shown for the purposes of this disclosure based on the average share price for the last three months for the year ended 31 December 2016 of 4,561.10p	**1,578**	
LTIP: award 22 March 2013 of 66,932 shares; performance period 2013/2015; award vested 22 March 2016 at 8.7% resulting in 5,823 shares; the award was exercised on 24 March 2016 at an execution price of 3,995.164p per share[4]		233
LTIP: cash dividend equivalent – a cash sum equivalent to the aggregated dividends that an LTIP participant would have received as a shareholder over the three-year period on the actual number of shares that vest under an LTIP award; 2016: (LTIP award 22 March 2013; vested at 8.7% on 22 March 2016); 2015: (LTIP award 28 March 2012; vested at 00.0% on 28 March 2015)	**26**	–
Total long-term incentives	**1,604**	233
Pension-related benefits[5]		
British American Tobacco UK Pension Fund	**–**	9
Unfunded unapproved retirement benefit scheme (UURBS – UK)	**309**	535
Total pension-related benefits	**309**	544
Other emoluments		
Life insurance	**14**	9
Share Reward Scheme: value of shares received during the year	**4**	2
Sharesave Scheme: grant of options on 23 March 2015 over 495 shares at an option price of 3,026.0p per share; options were awarded at a discount of 20% of the market value (3,782.0p per share) in accordance with the rules of the Sharesave Scheme	**–**	19
Total other emoluments	**18**	30
Total remuneration	**4,545**	3,332

Notes:

1. **Salary:** base salary from 1 April 2016: £867,000 (+0%) (from 1 April 2015: £867,000); UK-based employees received salary increases averaging around 3% and within a range of 0% to 8% with effect from 1 April 2016.
2. **Benefits:** the figures shown are gross amounts as in line with the UK market; it is the normal practice of the Company to pay the tax which may be due on any benefits, with the exception of the car or car allowance.
3. **DSBS:** an award of deferred shares attracts a payment of a cash sum equivalent to the dividend on the after-tax position on all unvested ordinary shares comprised in the share award held by the participant at each dividend record date and paid on or after the relevant dividend payment date.
4. **LTIP:** award 22 March 2013: an estimated value of £220,000 was disclosed in the Annual Report on Remuneration for the year ended 31 December 2015; these amounts have been re-presented to show the actual market value on the dates of exercise in 2016.
5. **Pension-related benefits:** these represent the net accrual for the period, being the differential between the individual's total pension entitlements as at 31 December 2015 (adjusted for inflation) and as at 31 December 2016, multiplied by 20 in accordance with the Regulations.
6. **External directorship:** Ben Stevens was appointed a non-executive director of ISS A/S on 5 April 2016. He retains the fees for this appointment, 2016: DKK525,000 (£58,833) (2015: DKK nil).

Annual Report on Remuneration continued

Base salary

The Executive Directors' salary review in February 2016 agreed the following, effective from 1 April 2016.

Executive Directors – salaries	Base salary from 1 Apr 2016 £	Percentage change %	Base salary from 1 Apr 2015 £
Nicandro Durante	**1,190,000**	00.0	1,190,000
Ben Stevens	**867,000**	00.0	867,000

Salaries with effect from 1 April 2017

The Remuneration Committee determined the following salaries for the Executive Directors: Nicandro Durante £1,250,000 (+5%) and Ben Stevens £893,000 (+3%). The increase for Nicandro Durante recognises his 'Outstanding' performance in 2016, in particular his individual leadership of the business in the year and his pivotal role in driving the Group's growth agenda. The increase for Ben Stevens reflects his very strong individual performance and his unique contribution to the Group's growth objectives. UK employees received salary rises based on a 3% increase budget, varying within a range extending from 0% to up to 8%, dependent on individual performance, time at grade and position relative to the external market.

Additional requirements in respect of the single total figure table

This section sets out supporting information and details for the single total figure for remuneration for the Executive Directors with particular reference to: the annual IEIS short-term incentive payments; the extent to which performance conditions have been satisfied for the LTIP; and further details on pension entitlements.

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

IEIS performance review – basics, measurement and process

IEIS awards	Year ended 2016
Performance period	Financial year ended 31 December 2016.
Payment	March 2017; no element of the bonus award is guaranteed.
Type	Variable performance-related.
Delivery	50% in cash; 50% in shares – deferred shares through the Deferred Share Bonus Scheme (DSBS). DSBS element: comprises free ordinary shares in the Company normally held in trust for three years and no further performance conditions apply in that period. Forfeiture may apply if a participant resigns before the end of the three-year period. Malus provisions: DSBS share awards made for 2014 onwards. Clawback provisions: from 2016, cash awards and share awards for performance ended 2015 onwards.
Review	By Remuneration Committee in February 2017 on basis of an internal report augmented by an assessment by the Group's external auditors of the relevant calculations.
Payout	Determined by actual performance for each measure, relative to that measure's performance points.
Discretion	The Remuneration Committee is able to override a proposed pay-out in circumstances where, in its judgement, the overall performance of the Company justifies a different outcome, whether higher or lower than that determined by the bonus formula.
Individual performance element	Awarded for 'Outstanding' performance, by adjusting upwards by up to 20% of the annual corporate IEIS result subject to the applicable maximum award limit; paid in cash. Individual performance rated as 'Requires Improvement' results in the corporate IEIS result being reduced by 50%. The Committee also reviews the personal performance of each Executive Director against their operational and strategic measures, which are agreed at the start of the year and which depend on the priorities for each Director's area of responsibility, in the context of the delivery of the Group strategy.

IEIS performance review – presentation of outcomes

Bonus targets and results 2015 and 2016
The Remuneration Committee considers annually the question of commercial confidentiality and the sensitivity of bonus targets and results. This review is considered against a background of the Group operating in a highly consolidated industry and being the second largest tobacco company in the world outside China with its two key competitors (the largest and third largest global tobacco companies) not subject to the same regulatory disclosures.
Specific performance measures, their weightings and actual performance/results achieved in 2016 are disclosed.
The **specific performance targets** for each measure are considered to be commercially sensitive. The Committee considers that its competitors would gain significant commercial insights into the Group's specific objectives and key priorities for its brands and markets if actual targets were disclosed year on year; such disclosure would be prejudicial to the interests of the Company and its shareholders.
The specific performance targets for each measure will only be disclosed retrospectively, at the earliest, in the Annual Report on Remuneration which relates to the period of 12 months after the end of the relevant IEIS performance period. The Committee has therefore agreed to disclose the specific Threshold and Maximum targets for the IEIS performance period ended 31 December 2015. These are shown in the following table.
It is expected that the specific Threshold and Maximum targets for the IEIS performance period ended 31 December 2016 will be published in March 2018 in the Annual Report for 2017.

IEIS: performance measures and targets year ended 31 December 2015	
IEIS: performance measure	**Description of measure and target 2015**
Adjusted profit from operations (growth over prior year) Weighting: 40%	Adjusted profit from operations of the Group's subsidiaries is at constant rates of exchange adjusted for the items shown as memorandum information in the Group Income Statement. **IEIS target 2015** Threshold: 1% growth over 2014 Maximum: 4% growth over 2014
Group's share of Key Markets (growth over prior year) Weighting: 20%	The Group's retail market share in its Key Markets accounts for around 80% of the volumes of the Group's subsidiaries. The Group's share is calculated from data supplied by retail audit service providers and is rebased as and when the Group's Key Markets change. When rebasing does occur, the Company will also restate history and provide fresh comparative data on the markets. **IEIS target 2015** Threshold: 0 bps growth over 2014 Maximum: 10 bps growth over 2014
Global Drive Brands (GDB) and Key Strategic Brands (KSB) volumes (growth over prior year) Weighting: 20%	GDB volumes comprise the cigarette volumes of Dunhill, Kent, Lucky Strike, Pall Mall and Rothmans, and include volumes of the Fine Cut variants of those brands sold in Western Europe. KSB volumes comprise the cigarette volumes of State Express 555 and Shuang Xi associated with the joint venture with CNTC in China. **IEIS target 2015** Threshold: 0.0% growth over 2014 Maximum: 1.7% growth over 2014
Cash generated from operations (as against adjusted budget) Weighting: 20%	Cash generated from operations is defined as the free cash flow excluding restructuring costs, dividends and other appropriations from associate undertakings measured at constant rates of exchange. **IEIS target 2015** Threshold: 5% less than 2015 budget Maximum: 5% above 2015 budget

IEIS: performance measures, weightings and results year ended 31 December 2016		
IEIS: performance measure	**Description of measure 2016**	**Actual performance 2016**
Adjusted profit from operations (growth over prior year) Weighting: 40% **Strategic target or objective** The medium- to long-term target is to grow adjusted profit from operations on average by 5–7% per year.	Adjusted profit from operations of the Group's subsidiaries is at constant rates of exchange adjusted for the items shown as memorandum information in the Group Income Statement.	Growth over the prior year of 4% **Strategic Report: Delivering our strategy – Productivity**
Group's share of Key Markets (growth over prior year) Weighting: 20% **Strategic target or objective** To continue to grow market share.	The Group's retail market share in its Key Markets accounts for around 80% of the volumes of the Group's subsidiaries. The Group's share is calculated from data supplied by retail audit service providers and is rebased as and when the Group's Key Markets change. When rebasing does occur, the Company will also restate history and provide fresh comparative data on the markets.	Global market share in key markets grew by 52 bps. **Strategic Report: Delivering our strategy – Growth**
Global Drive Brands (GDB) and Key Strategic Brands (KSB) volumes (growth over prior year) Weighting: 20% **Strategic target or objective** To increase our GDB and KSB volumes faster than the rest of the portfolio.	GDB volumes comprise the cigarette volumes of Dunhill, Kent, Lucky Strike, Pall Mall and Rothmans, and include volumes of the Fine Cut variants of those brands sold in Western Europe. KSB volumes comprise the cigarette volumes of State Express 555 and Shuang Xi associated with the joint venture with CNTC in China.	GDB and KSB volumes grew by 7.2% **Strategic Report: Delivering our strategy – Growth**

Annual Report on Remuneration continued

IEIS: performance measures, weightings and results year ended 31 December 2016

IEIS: performance measure	Description of measure 2016	Actual performance 2016
Cash generated from operations (as against adjusted budget) Weighting: 20% **Strategic target or objective** A specific target is set at each year for this measure with the aim to generate the optimal level cash flow while continuing to invest to support the short-, medium- and long-term requirements of the business.	Cash generated from operations is defined as the free cash flow excluding restructuring costs, dividends and other appropriations from associate undertakings measured at constant rates of exchange.	The improvement in cash generated from operations was 29.7%. **Strategic Report: Delivering our strategy – Productivity**

IEIS outcomes 2016 – Nicandro Durante

	2016 % of base salary	2016 £'000	2015 % of base salary	2015 £'000
Corporate result 50% in cash; 50% in deferred shares (DSBS)	**250.0**	**2,975**	200.0	2,380
Individual performance element up to 20% performance uplift on the corporate result (cash)			00.0	
2016 assessment: no individual performance uplift.	**00.0**	**–**		
Total IEIS result	**250.0**	**2,975**	200.0	2,380
Maximum opportunity	**250.0**		200.0	

IEIS outcomes 2016 – Ben Stevens

	2016 % of base salary	2016 £'000	2015 % of base salary	2015 £'000
Corporate result 50% in cash; 50% in deferred shares (DSBS)	**190.0**	**1,647**	180.0	1,560
Individual performance element up to 20% performance uplift on the corporate result (cash)			00.0	
2016 assessment: no individual performance uplift.	**00.0**	**–**		
Total IEIS result	**190.0**	**1,647**	180.0	1,560
Maximum opportunity	**190.0**		180.0	

Notes:
1. **IEIS payouts:** these are expressed as a percentage of salary with the actual payouts shown in the individual analysis tables on pages 60 and 61.
2. **DSBS:** awards made under the DSBS are in the form of free ordinary shares in the Company that normally vest after three years and no further performance conditions apply in that period. In certain circumstances, such as resigning before the end of the three-year period, participants may forfeit all of the shares. Malus-only provisions apply for DSBS share awards made for 2014 and 2015 and clawback provisions operate from 2016 IEIS cash awards and DSBS share awards for performance ended 2015.

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

Vesting of the 2014 LTIP awards in 2017: outcomes against performance measures

2014 LTIP awards	Performance measures			
Award date: 28 March 2014 Vesting date: 28 March 2017 Additional information describing the key elements supporting the performance measures and the management of LTIP awards are set out in the full Policy Report within the Annual Report 2015 on www.bat.com.	Total shareholder return (TSR) relative to a peer group of international FMCG companies 25% of award	Earnings per share (EPS) Compound annual growth relative to UK inflation measured at current rates of exchange 50% of award	Net turnover (NTO) Compound annual growth measured on an organic basis at constant rates of exchange 25% of award	NTO underpin Vesting is triggered if (on the assumption that threshold or above is achieved in respect of the NTO measure) the corresponding three-year constant compound annual growth rate (CAGR) of underlying profit exceeds the CAGR of the threshold performance level for underlying profit, as approved annually in the IEIS and approved by the Board
Performance period: 1 January 2014 – 31 December 2016	Ranked 3/23 Below median: nil vests At median: 6% vests At upper quartile: 25% vests	4.5% Less than 5% EPS: nil vests From 5%–10% EPS: 8%–50% vests pro rata between these two points	4.4% Less than 2% CAGR: nil vests From 2%–5% CAGR: 6%–25% vests pro rata between these two points	The underlying operating profit performance underpin for the NTO measure was exceeded with reference to the IEIS outcomes for 2014, 2015 and 2016
Percentage maximum achieved at end of performance period 31 December 2016: total vesting 46.0%	25%	00.0%	21.0%	

Vesting of 2014 LTIP awards held by Executive Directors	Number of shares awarded	Number of shares vesting/ % vesting	Number of shares lapsing/ % lapsing	**Value of shares vesting £'000**
Nicandro Durante	135,052	62,123 46.0%	72,929 54.0%	2,833
Ben Stevens	75,230	34,605 46.0%	40,625 54.0%	1,578

Notes:
1. **2014 LTIP awards**: these had not vested at the date of this report. The average share price for the last three months of the financial year has been used to determine the value of the 2014 LTIP awards for the purposes of the single total figure.
2. The average share price for the last three months for the year ended 31 December 2016 was 4,561.10p.

Annual Report on Remuneration continued

Current position on outstanding LTIP awards

The tables below show the current position against the performance targets for the outstanding LTIP awards for 2015 and 2016 for Executive Directors as at 31 December 2016. The key elements supporting the performance measures and the management of LTIP awards are set out on the Policy Report within the Annual Report 2015 on www.bat.com.

2015 LTIP awards: performance measures	Threshold	Maximum	**Indicative to 31 Dec 2016 2015 Award**	**Indicative % achieved at 31 Dec 2016 2015 Award**
Total shareholder return (TSR) ranking – a peer group of international FMCG companies at the beginning of the three-year performance period (1 January 2015 to 31 December 2017): **25% of award.**	At median (6% of award vests)	At upper quartile (25% of award vests)		
TSR outcome: the comparison is based on three months' average values. The Company achieved an upper quartile annualised TSR of 17.9%. One company in the comparator group has delisted during the performance period to date, 31 December 2016.			**Ranked 4/23**	**25.0%**
Earnings per share (EPS) – compound annual growth relative to UK inflation measured at current rates of exchange (EPS growth): **50% of award.**	At 5% EPS (8% of award vests)	At 10% EPS (50% of award vests)		
EPS outcome: this element of the award will vest in full if EPS growth over the three-year performance period is at least 10% per annum. 8% of the award will vest if the EPS growth over the performance period is 5%. An award will vest on a pro rata UK basis between these two points. None of the EPS portion of an award vests if EPS growth is less than 5% per annum.			**11.3%**	**50.0%**
Net turnover (NTO) – compound annual growth measured at constant rates of exchange: **25% of award.**	At 2% (6% of award vests)	At 5% (25% of award vests)		
NTO outcome: this element of the award will vest in full if CAGR over the three-year performance period is at least 5% per annum. 6% of the award will vest if CAGR over the performance period is 2%. An award will vest on a pro rata basis between these points. There is an underpin to this measure; vesting will only be triggered if (on the assumption that threshold or above is achieved in respect of the measure) the corresponding three-year constant compound annual growth rate (CAGR) of underlying operating profit exceeds the CAGR of the threshold performance level for underlying operating profit, as defined annually in the IEIS and is approved by the Board.			**5.3%**	**25.0%**
Total				**100.0%**

2016 LTIP awards[1]: performance measures	Threshold	Maximum	Indicative to 31 Dec 2016 2016 Award	Indicative % achieved at 31 Dec 2016 2016 Award
Total shareholder return (TSR) ranking – a peer group of international FMCG companies at the beginning of the three-year performance period (1 January 2016 to 31 December 2018): **20% of award.**	At median (3% of award vests)	At upper quartile (20% of award vests)		
TSR outcome: the comparison is based on three months' average values prior to the start and at the final year of the performance period. The Company achieved an upper-quartile annualised TSR of 25%. One company in the comparator group has delisted during the performance period to date, 31 December 2016.			**Ranked 1/23**	**20.0%**
Earnings per share (EPS) – the compound annual growth rate (CAGR) in adjusted diluted EPS measured in sterling at current rates of exchange (EPS growth): **20% of award**.	At 5% CAGR (3% of award vests)	At 10% CAGR (20% of award vests)		
EPS outcome: this element of the award will vest in full if the EPS growth over the three-year performance period is at least 10% per annum. 3% of the award will vest if the EPS growth over the performance period is 5%. An award will vest on a pro rata basis between these two points. None of the EPS portion of an award vests if the EPS growth is less than 5% per annum.			**13.7%**	**20.0%**
Earnings per share (EPS) – the compound annual growth rate (CAGR) in adjusted diluted EPS measured in sterling at constant rates of exchange (the EPS growth): **20% of award**.	At 5% CAGR (3% of award vests)	At 10% CAGR (20% of award vests)		
EPS outcome: this element of the award will vest in full if the EPS growth over the three-year performance period is at least 10% per annum. 3% of the award will vest if the EPS growth over the performance period is 5%. An award will vest on a pro rata basis between these two points. None of the EPS portion of an award vests if the EPS growth is less than 5% per annum.			**8.4%**	**14.5%**
Net turnover (NTO) – compound annual growth (CAGR) measured at constant rates of exchange: **20% of award.**	At 3% NTO (3% of award vests)	At 5% NTO (20% of award vests)		
NTO outcome: this element of the award will vest in full if CAGR over the three-year performance period is at least 5% per annum. 3% of the award will vest if the CAGR over the performance period is 3%. An award will vest on a pro rata basis between these two points. None of the NTO portion of an award vests if CAGR is less than 3% per annum. There is an underpin to this measure; vesting will only be triggered if (on the assumption that threshold or above is achieved in respect of the measure) the corresponding three-year constant compound annual growth rate (CAGR) of underlying operating profit exceeds the CAGR of the threshold performance level for underlying operating profit, as defined annually in the IEIS and is approved by the Board.			**4.9%**	**19.5%**
Operating cash flow conversion ratio (OCF) – measured at actual rates, expressed as percentage of adjusted operating profit: **20% of award.**	At 85% OCF (3% of award vests)	At 95% OCF (20% of award vests)		
OCF outcome: this element of the award will vest in full if the Company achieves a ratio of OCF to adjusted profit of 95% or more on average over the performance period. 3% of the award will vest if the OCF conversion ratio is 85% on average over the performance period. An award will vest on a pro rata basis between these two points. None of the OCF portion of an award vests if the ratio is less than 85%. Adjusted operating profit is as defined for the purposes of the IEIS, except as for actual rates of exchange.			**92.5%**	**15.8%**
Total				**89.8%**

Note
1. **LTIP Extended Vesting Period:** there is an additional vesting period of two years from the third anniversary of the date of grant. The LTIP award will vest only to the extent that: (1) the performance conditions or measures are satisfied at the end of the three-year performance period; (2) an additional vesting period of two years from the date of the third anniversary of the date of grant has been completed i.e. the LTIP Extended Vesting Period. The LTIP award is therefore only exercisable once the total period of five years from the date of grant has been completed.

Annual Report on Remuneration continued

Vesting of past LTIP awards for the years ended 2012 to 2016

The following table shows the historical vesting of awards over the five-year period for the years ended 31 December 2012 to 31 December 2016, inclusive.

LTIP award date	28 Mar 2014	22 Mar 2013	28 Mar 2012	13 May 2011	25 Mar 2010
Year ended	31 Dec 2016	31 Dec 2015	31 Dec 2014	31 Dec 2013	31 Dec 2012
Performance period	2014/2016	2013/2015	2012/2014	2011/2013	2010/2012
Vesting date	28 Mar 2017	22 Mar 2016	28 Mar 2015	13 May 2014	25 Mar 2013
Total vesting percentage	46.0	8.7	00.0	49.2	87.1

All-employee share schemes

The Company operates the following all-employee share schemes in which the Executive Directors participate, as shown as at 31 December 2016.

Executive Directors	Nicandro Durante	Ben Stevens
All-employee share schemes:	✓	✓
Sharesave Scheme	✓	✓
Share Incentive Plan (Partnership Scheme)	✓	✓
Share Incentive Plan (Share Reward Scheme)	✓	✓

Percentage change in the Chief Executive's remuneration

The following table shows the percentage change in the Chief Executive's remuneration measured against a comparator group comprising the UK employee population on UK employment contracts (2016: 2,022 individuals; 2015: 1,971 individuals[1]). This comparator group is considered to be the most appropriate group as Executive Directors are employed on UK contracts. Using a more widely drawn group encompassing the worldwide nature of the Group's business would also present practical difficulties in collation as well as presenting a less relevant comparator given the significant variations in employee pay across the Group and the differing economic conditions and wide variations in GDP per capita.

	Base salary			Taxable benefits			Short-term incentives		
	2016 £'000	2015 £'000	Change %	2016 £'000	2015 £'000	Change %	2016 £'000	2015 £'000	Change %
Nicandro Durante (Chief Executive)	1,190	1,181	0.8	235	155	51.6	2,975	2,380	25.0
UK-based employees	70	69[1]	1.4	4	4	–	25	23[1]	8.7

Notes:
UK-based employees:
1. The data for the 2015 comparator has been updated to reflect actual individual employee numbers and costs in 2015.
2. The data for this comparator group is made up as follows as at 31 December 2016: (1) the weighted average base salaries; (2) the average taxable benefits per grade; and (3) an estimated weighted average target bonus based on that population as at that date.
3. UK-based employees were awarded performance-based pay increases in the range 0% to 8% with an average of around 3%.

'Single figure' table for Non-Executive Directors' remuneration: aggregate – audited

The following table shows a single figure of remuneration for the Non-Executive Directors in respect of qualifying services for the year ended 31 December 2016 together with comparative figures for 2015. The aggregate Directors' emoluments are shown on page 70.

Non-Executive Directors[1]	Base fee[2] £'000		Chair/Committee membership fees[2] £'000		Taxable benefits[3] £'000		Total remuneration £'000	
	2016	2015	**2016**	2015	**2016**	2015	**2016**	2015
Sue Farr (from 2 February 2015)	**93**	85	**13**	11	**1**	2	**107**	98
Ann Godbehere	**93**	93	**18**	18	**1**	2	**112**	113
Marion Helmes (from 1 August 2016)	**39**	n/a	**5**	n/a	**5**	n/a	**49**	n/a
Savio Kwan	**93**	93	**13**	12	**37**	42	**143**	147
Pedro Malan (from 2 February 2015)	**93**	85	**13**	11	**44**	42	**150**	138
Gerry Murphy	**93**	93	**13**	20	**1**	1	**107**	114
Dimitri Panayotopoulos (from 2 February 2015)	**93**	85	**19**	11	**4**	13	**116**	109
Kieran Poynter	**93**	93	**48**	42	**0**	–	**141**	135
Retired Non-Executive Directors								
Karen de Segundo (to 27 April 2016)	**30**	93	**10**	31	**0**	–	**40**	124
Christine Morin-Postel (to 6 December 2016)	**86**	93	**59**	64	**9**	16	**154**	173
Richard Tubb (to 27 April 2016)	**30**	93	**4**	12	**20**	35	**54**	140
Total	**836**	906	**215**	232	**122**	153	**1,173**	1,291

Notes:

1. **Committee memberships:** are shown, together with changes during the year, in the reports of the respective committees in the Governance sections of the Directors' Report. The CSR Committee was removed as a Board committee with effect from 28 April 2016.
2. **Non-Executive Directors' fees structure 2016:** set out in the table below.

	To 1 May 2016 £	From 1 May 2016 £
Base fee	**92,700**	92,700
Senior Independent Director – supplement	**30,000**	32,000
Audit Committee: Chairman	**30,000**	32,000
Audit Committee: Member	**6,000**	7,000
CSR Committee: Chairman (up to 28 Apr 2016)	**25,000**	n/a
CSR Committee: Member (up to 28 Apr 2016)	**6,000**	n/a
Nominations Committee: Chairman	**–**	–
Nominations Committee: Member	**6,000**	7,000
Remuneration Committee: Chairman	**30,000**	32,000
Remuneration Committee: Member	**6,000**	7,000

3. **Benefits**

(a) In line with the Policy, the figures shown are gross amounts (as appropriate) as in line with the UK market, as it is the normal practice of the Company to pay the tax that may be due on any benefits.

(b) **Taxable benefits:** comprise travel expenses and 'walk-in' medical services.

(c) **'Walk-in' medical services**: the Non-Executive Directors received this benefit in 2016 to the value of £262 each (2015: £255).

Annual Report on Remuneration continued

'Single figure' table for the Chairman's remuneration: aggregate – audited

The following table shows a single figure of remuneration for the Chairman in respect of qualifying services for the year ended 31 December 2016 together with comparative figures for 2015. The aggregate Directors' emoluments are shown below.

Chairman – Richard Burrows	2016 £'000	2015 £'000
Fees		
£645,000 (from 1 April 2016)	**645**	642
Taxable benefits		
– health insurance and 'walk-in' medical services[2]	**14**	13
– use of a company driver	**69**	55
– home and personal security in the UK and Ireland	**6**	4
– hotel accommodation and related expenses incurred in connection with individual and/or accompanied attendance at certain business functions and/or corporate events	**9**	4
– commuting flights to London[3]	**8**	9
Total remuneration	**751**	727

Notes:
1. **Benefits:** in line with the Policy, the figures shown for taxable benefits are gross amounts (as appropriate) as it is the normal practice of the Company to pay any tax due on such benefits.
2. **'Walk-in' medical services:** Richard Burrows received this benefit in 2016 to the value of £262 (2015: £255).
3. **Commuting flights to London:** treated as a taxable benefit from 6 April 2015.
4. **Salary with effect from 1 April 2017:** in keeping with the level of pay awards granted to UK employees based on a 3% increase budget, varying within a range extending from 0% to up to 8% (dependent on individual employee time in grade, performance during the preceding year and position relative to the external market) the Remuneration Committee determined the Chairman's fee at £665,000 (+3.1%).

Aggregate Directors' emoluments – audited

The following table shows the aggregate emoluments of the Directors of the Company.

	Executive Directors		Chairman		Non-Executive Directors		Total	
	2016 £'000	2015 £'000	2016 £'000	2015 £'000	2016 £'000	2015 £'000	2016 £'000	2015 £'000
Salary; fees; benefits; incentives								
Salary	**2,057**	2,042					**2,057**	2,042
Fees			**645**	642	**1,051**	1,138	**1,696**	1,780
Taxable benefits	**335**	259	**106**	85	**122**	153	**563**	497
Short-term incentives	**4,622**	3,940					**4,622**	3,940
Long-term incentives	**4,483**	647					**4,483**	647
Sub-total	**11,497**	6,888	**751**	727	**1,173**	1,291	**13,421**	8,906
Pension; other emoluments								
Pension	**634**	936					**634**	936
Other emoluments	**44**	51					**44**	51
Sub-total	**678**	987					**678**	987
Total emoluments	**12,175**	7,875	**751**	727	**1,173**	1,291	**14,099**	9,893

Total pension entitlements

Executive Directors' pension entitlements – audited

Pension values	Accrued pension at year end 31 Dec 2016 £'000	Additional value of pension on early retirement
Nicandro Durante (normal retirement age: 60)		
UURBS (UK)	**122**	–
Total	**122**	–

Nicandro Durante's **UURBS** pension entitlements are derived as follows:

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

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

Total accrued pension is the amount of pension that would be paid annually on retirement based on service to the end of the year.
The pension-related benefits disclosed in the single figures for Directors' remuneration represent Nicandro Durante's net accrual for the period, being the differential between his total pension entitlements as at 31 December 2015 (adjusted for inflation) and as at 31 December 2016, multiplied by 20 in accordance with the Regulations.

Nicandro Durante receives a pension in payment from the Fundação Albino Souza Cruz (FASC) from Souza Cruz S.A., a Brazilian registered wholly-owned subsidiary of the Group. This pension benefit has been in payment since April 2012 and currently amounts to approximately £318,500 per annum (after adjusting for currency exchange) reflecting his 31 years' service at Souza Cruz.

Pension values	Accrued pension at year end 31 Dec 2016 £'000	Additional value of pension on early retirement
Ben Stevens (normal retirement age: 60)		
British American Tobacco UK Pension Fund	**98**	–
UURBS (UK)	**280**	–
Total	**378**	–

Ben Stevens joined the **UK Pension Fund** after 1989 and before the closure of its non-contributory defined benefit section to new members in April 2005. As a result, prior to 6 April 2006, he was subject to the HMRC cap on pensionable earnings (notionally £151,200 for the tax year 2016/17). In addition, he has an unfunded pension promise from the Company in respect of earnings above the cap on an equivalent basis to the benefits provided by the UK Pension Fund. This is provided through membership of an unfunded unapproved retirement benefit scheme (UURBS). Further to the changes to the applicable tax regulations, Ben Stevens has reached his lifetime allowance of £1.8 million and therefore has ceased accrual in the Pension Fund with all future benefits being provided through membership of the UURBS. During the year, there has been no change to the overall pension entitlement of Ben Stevens.

Total accrued pension is the amount of pension that would be paid annually on retirement based on service to the end of the year. The pension-related benefits disclosed in the single figures for Directors' remuneration represent Ben Stevens' net accrual for the period, being the differential between his total pension entitlements as at 31 December 2015 (adjusted for inflation) and as at 31 December 2016, multiplied by 20 in accordance with the Regulations.

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

Note:
1. **UK Pension Fund:** this is non-contributory. Voluntary contributions paid by an Executive Director and resulting benefits are not shown. No excess retirement benefits have been paid to or are receivable by an Executive Director or past Executive Director.

Annual Report on Remuneration continued

Directors' shareholdings and scheme interests

Executive Directors' shareholding guidelines

Executive Directors are encouraged to build up a high level of personal shareholding to ensure a continuing alignment of interests with shareholders. The shareholding guidelines require Executive Directors to hold shares in the Company equal to the value of a percentage of salary as set out in the table below.

	Shareholding requirements (% of base salary 31 Dec 2016)	No. of eligible ordinary shares held at 31 Dec 2016	Value of eligible ordinary shares held at 31 Dec 2016 £m	Actual percentage (%) of base salary at 31 Dec 2016
Nicandro Durante	500	**280,580**	**13.0**	**1092.4**
Ben Stevens	350	**105,827**	**4.9**	**565.2**

Notes:

1. **Eligibility of shares:** (a) shares earned but not yet vested and for which performance conditions have already been met under the DSBS element of the IEIS are included in the calculation of the threshold for the shareholding guidelines for Executive Directors; (b) shares earned but not yet vested under the long-term (LTIP) incentive plans are not eligible and do not count towards the shareholding requirement although the estimated notional net number of shares held by an Executive Director in the LTIP Extended Vesting Period will count towards the respective shareholding requirements; and (c) shares held in trust under the all-employee share ownership plan (SIP) are not eligible and do not count towards the shareholding requirement.
2. **Closing mid-market price:** at 30 December 2016 (being the last trading day of the year) was 4,621.5p.
3. **Meeting the guidelines:** if an Executive Director does not, at any time, meet the requirements of the shareholding guidelines, the individual may, generally, only sell a maximum of up to 50% of any shares vesting (after tax) under the Company share plans until the threshold required under the shareholding guidelines has been met.
4. **Waiver of compliance with guidelines:** this is permitted with the approval of the Remuneration Committee in circumstances where a restriction on a requested share sale could cause undue hardship. No such applications were received from the Executive Directors during 2016.
5. **Non-Executive Directors:** are not subject to any formal shareholding requirements although they are encouraged to build a small interest in shares during the term of their appointment.

Executive Directors' share interests – audited

The interests of the Executive Directors who served during the year ended 31 December 2016 in the ordinary shares of the Company (beneficial, family and any connected persons) are as follows:

	At 1 Jan 2016	Awarded on 29 Mar 2016	Released 22 Mar 2016[2]	At 31 Dec 2016	Changes from 31 Dec 2016[5]
Nicandro Durante					
Shares held[1]	188,959			**204,005**	
SIP shares[3] – held in employee benefit trust	1,724			**1,917**	6
DSBS: deferred shares – unvested, subject to continued employment	72,363	29,690	(25,478)	**76,575**	
Total share interests	263,046			**282,497**	
Ben Stevens					
Shares held[1]	72,136			**55,271**	
SIP shares[3] – held in employee benefit trust	535			**549**	6
DSBS: deferred shares – unvested, subject to continued employment	48,167	19,468	(17,079)	**50,556**	
Total share interests	120,838			**106,376**	

Notes:

1. **Shares held – owned outright:** these have not been pledged as security against loans.
2. **DSBS – deferred shares**: the closing mid-market price on the date of release (22 March 2016) was 3,983.0p.
3. **SIP shares**: these comprise vested and unvested shares in the Share Incentive Plan (Partnership Share Scheme and Share Reward Scheme).
4. **Share Reward Scheme**: based on the performance for the year ended 31 December 2016, the Executive Directors will each be awarded a number of ordinary shares to the value of £3,600 on 3 April 2017.
5. **Changes from 31 December 2016**: these relate to purchases by Nicandro Durante and Ben Stevens of a total of six ordinary shares each under the Partnership Share Scheme on 4 January 2017 and 1 February 2017.
6. **BATGET**: on 31 December 2016, the Group's employee share ownership trust, referred to later in this Remuneration Report, held a total of 5,137,602 ordinary shares in the Company. All participating employees, including the Executive Directors, are deemed to have a beneficial interest in these shares.

Chairman and Non-Executive Directors' share interests – audited

The interests of the Chairman and Non-Executive Directors who served during the year ended 31 December 2016 in the ordinary shares of the Company (beneficial, family and any connected persons) are as follows:

	At 1 Jan 2016	At 31 Dec 2016
Chairman		
Shares held[1]		
Richard Burrows	15,000	**15,000**
Non-Executive Directors		
Shares held[1]		
Sue Farr	–	**–**
Ann Godbehere[2]	3,100	**3,100**
Marion Helmes (from 1 August 2016)	n/a	**4,500**
Savio Kwan	3,040	**3,148**
Pedro Malan	–	**–**
Gerry Murphy	5,000	**5,000**
Dimitri Panayotopoulos	3,300	**3,300**
Kieran Poynter	5,000	**5,000**
Former Non-Executive Directors		
Shares held[1]		
Karen de Segundo (to 27 April 2016)	2,000	**n/a**
Christine Morin-Postel (to 6 December 2016)	3,000	**n/a**
Richard Tubb (to 27 April 2016)	–	**n/a**

Notes:

1. **Shares held – owned outright:** these have not been pledged as security against loans.
2. **Ann Godbehere:** these share interests consist of 1,550 American Depositary Receipts (ADRs), each of which, from 14 February 2017, represents one ordinary share in the Company. Prior to that date, each ADR represented two ordinary shares in the Company.
3. **Changes from 31 December 2015:** there were no changes in the share interests of the Chairman and the Non-Executive Directors.

Scheme interests – share incentive awards – audited

The scheme interests of the Executive Directors who served during the year ended 31 December 2016 in the shares of the Company under the Long-Term Incentive Plan (LTIP) and who received LTIP awards during the year ended 31 December 2016 are as follows:

LTIP awards[1]	LTIP shares balance 1 Jan 2016	LTIP shares awarded in 2016	Award date	LTIP shares vested at 8.7% on 22 Mar 2016	LTIP shares lapsed in 2016	LTIP shares exercised in 2016[2]	LTIP shares balance 31 Dec 2016
Nicandro Durante	119,828		22 Mar 2013	10,425	109,403	10,425	**–**
	135,052		28 Mar 2014				**135,052**
	127,448		27 Mar 2015				**127,448**
		140,529	12 May 2016[3]				**140,529**
Total	382,328	140,529		10,425	109,403	10,425	**403,029**
Ben Stevens	66,932		22 Mar 2013	5,823	61,109	5,823	**–**
	75,230		28 Mar 2014				**75,230**
	69,641		27 Mar 2015				**69,641**
		71,669	12 May 2016[3]				**71,669**
Total	211,803	71,669		5,823	61,109	5,823	**216,540**

Notes:

1. **LTIP awards and interests**

Award date	Performance period	Exercisable	LTIP Scheme
22 Mar 2013	1 Jan 2013 – 31 Dec 2015	22 Mar 2016 – 21 Mar 2023	2007
28 Mar 2014	1 Jan 2014 – 31 Dec 2016	28 Mar 2017 – 27 Mar 2024	2007
27 Mar 2015	1 Jan 2015 – 31 Dec 2017	27 Mar 2018 – 26 Mar 2025	2007
12 May 2016	1 Jan 2016 – 31 Dec 2018	12 May 2021 – 11 May 2026[(c)]	2016

(a) Awards of shares made under the LTIP Schemes are for nil consideration. (b) The performance conditions for the LTIP awards made in 2014 and 2015 and the awards made in 2016 under the new LTIP are detailed in the Summary of the Future Policy Table set out above; there have been no other variations in the terms and conditions of the LTIP interests during 2016. (c) **LTIP Extended Vesting Period**: there is an additional vesting period of two years from the third anniversary of the date of grant. The LTIP award will vest only to the extent that: (1) the performance conditions or measures are satisfied at the end of the three-year performance period; (2) an additional vesting period of two years from the date of the third anniversary of the date of grant has been completed i.e. the LTIP Extended Vesting Period. The LTIP award is therefore only exercisable once the total period of five years from the date of grant has been completed.

Remuneration Report

Annual Report on Remuneration continued

2. **Aggregate gains on LTIP shares exercised in the year**

	Award	Exercised LTIP shares	Exercise date	Price per share (p)	Aggregate gain £
Nicandro Durante	22 Mar 2013	10,425	22 Mar 2016	3,973.500	414,237
Ben Stevens	22 Mar 2013	5,823	24 Mar 2016	3,995.164	232,638

3. **Award 12 May 2016**

	Shares awarded	Multiple of base salary	Price per Share (p)[(a)]	Face value of award £m	Percentage of award vesting at threshold performance
Nicandro Durante	140,529	500%	4,234.00	5,950	15%
Ben Stevens	71,669	350%	4,234.00	3,034	15%

(a) The price per share is calculated by reference to the closing mid-market price of the Company's ordinary shares, being an average over the three dealing days preceding the date of grant of the award.

Scheme interests – share options – audited

The scheme interests of the Executive Directors who served during the year ended 31 December 2016 in the shares of the Company under the Sharesave Scheme are as follows:

Sharesave options[1]	At 1 Jan 2016 Number of shares	Grant date	Grant price pence	Granted in 2016	Exercised in 2016	Lapsed in 2016	At 31 Dec 2016 Number of shares	Date from which exercisable	Latest expiry date
Nicandro Durante	591	28 Mar 2012	2,536.0				**591**	May 2017	Oct 2017
	543	26 Aug 2014	2,787.0				**543**	Oct 2019	Mar 2020
Total	1,134						**1,134**		
Ben Stevens	543	26 Aug 2014	2,787.0				**543**	Oct 2019	Mar 2020
	495	23 Mar 2015	3,026.0				**495**	May 2020	Oct 2020
Total	1,038						**1,038**		

Note:

1. **Sharesave:** (a) there were no variations in the terms and conditions of these interests in share options during the year; (b) no Sharesave options were exercised by the Executive Directors in the year – the total aggregate gains on the exercise of share options was £nil (2015: £22,235); (c) options granted under the Sharesave Scheme are exercisable in conjunction with a three-year or five-year savings contract up to a monthly limit of £500; (d) options are normally granted at a discount of 20% to the market price at the time of invitation, as permitted by the rules of the Sharesave Scheme (2012: 3,170.0p; 2014: 3,483.0p; and 2015: 3,782.0p).

Shareholder dilution – options and awards outstanding

Satisfaction of Company share plan awards in accordance with the Investment Association's Principles of Remuneration

- by the issue of new shares; or
- shares issued from treasury only up to a maximum of 10% of the Company's issued share capital in a rolling 10-year period;
- within this 10% limit, the Company can only issue (as newly issued shares or from treasury) 5% of its issued share capital to satisfy awards under discretionary or executive plans; and
- the rules of the Company's Deferred Share Bonus Scheme (DSBS) do not allow for the satisfaction of awards by the issue of new shares.

New ordinary shares issued by the Company during the year ended 31 December 2016

- 152,784 ordinary shares issued by the Company in relation to the Sharesave Scheme;
- a total of 825,888 Sharesave Scheme options over ordinary shares in the Company were outstanding at 31 December 2016, representing 0.04% of the Company's issued share capital (excluding shares held in treasury); and
- options outstanding under the Sharesave Scheme are exercisable until end October 2021 at option prices ranging from 2,536p to 3,132p.

The British American Tobacco Group Employee Trust (BATGET)

BATGET	
Function	– used to satisfy the vesting and exercise of awards of ordinary shares under the DSBS and LTIP; and – a committee of senior management reporting to the Board's Share Schemes Committee monitors the number of shares held in BATGET to satisfy outstanding awards.
Funding	– funded by interest-free loan facilities from the Company totalling £1 billion; – this enables BATGET to facilitate the purchase of ordinary shares to satisfy the future vesting or exercise of options and awards; – loan to BATGET: £369.5 million at 31 December 2016 (2015: £313 million); – the loan is either repaid from the proceeds of the exercise of options or, in the case of ordinary shares acquired by BATGET to satisfy the vesting and exercise awards, the Company will subsequently waive the loan provided over the life of the awards; and – if any options lapse, ordinary shares may be sold by BATGET to cover the loan repayment.
Shares held in BATGET	(see table below)
Dividends	– BATGET currently waives dividends on the ordinary shares held by it; – final dividend 2015: £5.5 million in May 2016; and – interim dividend 2016: £2.7 million in September 2016.
Voting rights	– the trustee does not exercise any voting rights while shares are held in BATGET; and – share scheme participants may exercise the voting rights attaching to those shares once the shares have been transferred out of BATGET.

Shares held in BATGET:

	1 Jan 2016	31 Dec 2016
Number of ordinary shares	5,365,084	**5,137,602**
Market value of ordinary shares	£202.0m	**£237.4m**
% of issued share capital of Company	0.26	**0.25**

Note:
1. **Company share-based payment arrangements:** details of the material equity share-based and cash-settled share-based arrangements are set out in note 25 on the accounts.
2. **Closing mid-market price** at 30 December 2016 (being the last trading day of the year) was 4,621.5p (31 December 2015: 3,771.0p).

Other required disclosures

Payments to former Directors and payments for loss of office – audited

In October 2016, the Company agreed to make a one-off payment to Robert Lerwill (a former Non-Executive Director of the Company from 2005 to 2013) of £171,000. This payment was made in respect of Robert Lerwill's service as the Group's nominee director of ITC Limited (an associate undertaking of the Group) which position he had vacated for personal reasons in June 2016. The Company did not make: (1) any other payments of money or other assets to former Directors; or (2) any payments to Directors for loss of office during the year ended 31 December 2016.

Voting on the Remuneration Report at the 2016 AGM and engagement with shareholders

At the AGM on 27 April 2016, the shareholders considered and voted on the Directors' Remuneration Report as set out on the table below. No other resolutions in respect of Directors' remuneration and incentives were considered at the AGM.

	Approval of Directors' Remuneration Policy[1] 2016[1]	Approval of Directors' Remuneration Report[2] 2016[2]
Percentage for	**90.32**	**94.49**
Votes for (including discretionary)	**1,191,242,495**	**1,254,887,608**
Percentage against	**9.68**	**5.51**
Votes against	**127,646,481**	**73,116,552**
Total votes cast excluding votes withheld	**1,318,888,976**	**1,328,004,160**
Votes withheld[3]	**103,597,686**	**94,481,732**
Total votes cast including votes withheld	**1,422,486,662**	**1,422,485,892**

Notes:
1. **Directors' Remuneration Policy:** was approved by shareholders at the AGM on 27 April 2016 and is set out in full in the Annual Report 2015. A summary of this Policy is on pages 49 to 55 of this Remuneration Report 2016.
2. **Directors' Remuneration Report:** does not include the part of the Remuneration Report containing the Remuneration Policy (see note 1 above).
3. **Votes withheld:** these are not included in the final proxy figures as they are not recognised as a vote in law.

Annual Report on Remuneration continued

During the latter part of 2015 and early 2016, the Company undertook a programme of engagement and consultation with about 60% of its shareholders regarding proposals for changes to the existing Remuneration Policy which included the introduction of a new LTIP. These changes are described in detail in the Remuneration Report 2015 in the context of three principal discussion themes: (1) a current LTIP that did not function effectively to incentivise and reward management to drive the strategic fundamentals was not in the interests of shareholders; (2) measured over several years, the Company's underlying performance had remained extremely strong; and (3) a need to increase the award potential for Executive Directors to ensure competitiveness in the market.

The consultation process elicited a diverse range of view and opinions which crystallised into positive support for the new Remuneration Policy (90% of votes) and the new LTIP (91% of votes) at the AGM on 27 April.

Directors' remuneration in the year ending 31 December 2017

Proposed implementation of Remuneration Policy in 2017

The Remuneration Policy for the Executive Directors and the Non-Executive Directors applicable in 2016 was approved by shareholders at the Annual General Meeting on 27 April 2016. It is set out in full in the Future Policy Table for Executive Directors and the Remuneration Table for the Chairman and the Non-Executive Directors in the Annual Report 2015 on www.bat.com. A summary of the Remuneration Policy is set out on pages 49 to 55 of this Remuneration Report. In accordance with the Regulations, a Remuneration Policy will be put to shareholders again no later than the 2019 AGM.

On behalf of the Board

Dimitri Panayotopoulos
Chairman, Remuneration Committee
22 February 2017

Governance

Other corporate disclosures

Strategic Report disclosures

Section 414C(11) of the Companies Act 2006 allows the Board to include in the Strategic Report information that it considers to be of strategic importance that would otherwise need to be disclosed in the Directors' Report. The Board has chosen to take advantage of this provision and accordingly, the information set out below, which would otherwise be required to be contained in the Directors' Report, has been included in the Strategic Report.

Information required in the Directors' Report	Section in the Strategic Report
Certain risk information about the use of financial instruments.	Financial review
An indication of likely future developments in the business of the Group.	Delivering our Strategy
An indication of the activities of the Group in the field of research and development.	Our business model
A statement describing the Group's policy regarding the hiring, continuing employment and training, career development and promotion of disabled persons.	Delivering our strategy: Winning Organisation
Details of employee engagement: information, consultation, share scheme participation and the achievement of a common awareness of the financial and economic factors affecting the performance of the Group.	Delivering our strategy: Winning Organisation
Disclosures concerning greenhouse gas emissions.	Delivering our strategy: Sustainability

Listing Rules (LRs) disclosures

For the purpose of LR 9.8.4C R the applicable information required to be disclosed by LR 9.8.4 R	Section in this Annual Report
Section (12) – shareholder waivers of dividends	Remuneration report, page 75 and other corporate disclosures, page 78.
Section (13) – shareholder waivers of future dividends	Remuneration report, page 75 and other corporate disclosures, page 78.

Dividends

Final dividend Year-Ended 31 December 2016	Details
Recommended by the Board for approval by shareholders at AGM on 26 April 2017.	118.1p per ordinary share of 25p each
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 = 16.32100 as at 21 February 2017 (the closing rate for that date as quoted on Bloomberg), results in an equivalent final dividend of 1,927.51010 SA cents per ordinary share.
South Africa Dividends Tax information – this is only of direct application to shareholders on the South Africa branch register. Shareholders on the South Africa branch register should refer to 'Shareholder and contact information' for the contact details of Computershare Investor Services Proprietary Limited, the Company's registrar for the branch register. British American Tobacco p.l.c. is registered with the South African Revenue Service (SARS) with tax reference number 9378193172.	South Africa Dividends Tax (at a rate of 15%) equivalent to 289.12652 SA cents per ordinary share will be withheld from the gross final 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 1,638.38359 SA cents per ordinary share. The final dividend is regarded as a 'foreign dividend' for the purposes of the South Africa Dividends Tax.

Key dates and the South Africa branch register

In compliance with the requirements of the London Stock Exchange (LSE) and Strate, the electronic settlement and custody system used by the JSE Limited (JSE), the following are the salient dates for the payment of the final dividend.

Event	Date 2017
Preliminary announcement	23 February
Last day to trade (LDT) cum-dividend (JSE)	14 March
Shares commence trading ex-dividend (JSE)	15 March
Shares commence trading ex-dividend (LSE)	16 March
Record date (JSE and LSE)	17 March
Payment date	4 May
No removal requests (in either direction) permitted between the UK main register and the South Africa branch register	23 February – 17 March
No transfers permitted between the UK main register and the South Africa branch register	15 March – 17 March
No shares to be dematerialised or rematerialised on the South Africa branch register	15 March – 17 March

Note:
Further details of the total amounts of dividends paid in 2016 (with 2015 comparatives) are given in note 8 on the accounts.

Other corporate disclosures continued

Annual General Meeting 2017

Venue	Milton Court Concert Hall, Silk Street, London EC2Y 9BH
Date	Wednesday 26 April 2017
Time	11:30am
Notice	Details of the business to be proposed at the meeting are contained in the Notice of AGM, which is made available to all shareholders and is published on www.bat.com.
Voting	The Company provides for the vote on each resolution to be by poll rather than by show of hands. This provides for greater transparency and allows the votes of all shareholders to be counted, including those votes cast by proxy. The voting results are announced on the same day on the London Stock Exchange and the Johannesburg Stock Exchange (JSE) through the Regulatory News Service (RNS) and the Stock Exchange News Service (SENS) respectively. The voting results will also be made available on www.bat.com.

Share capital

Share capital Ordinary shares of 25p each	31 Dec 2016	21 February 2017[1]
Issued ordinary shares (excluding treasury shares)	1,864,373,918	1,864,374,894
Treasury shares	162,645,590	162,645,590
Total allotted and fully paid ordinary shares (including treasury shares and shares owned by employee share trusts)	2,027,019,508	2,027,020,484
Aggregate nominal value £m	506.8	506.8

Note:
1. The latest practicable date prior to the recommendation of the final dividend for the year ended 31 December 2016.

Significant shareholders

At 31 December 2016, the following substantial interests (3% or more) in the Company's ordinary share capital (voting securities) had been notified to the Company in accordance with Section 5.1.2 of the Disclosure Guidance and Transparency Rules. As at 22 February 2017, the Company had not received notification either of any change in the interests below or that any other person holds 3% or more of its ordinary shares.

Name	Number of ordinary shares	% of issued share capital[1]
BlackRock, Inc.	132,891,526	7.13
Reinet Investments S.C.A.	76,518,264	4.10
The Capital Group Companies, Inc.	94,321,111	5.06

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

Renewal of authority for Company to purchase own shares

Current authority to purchase shares	– this authority (granted at the 2016 AGM) will expire at the 2017 AGM; – share buy-back programme was suspended with effect from 30 July 2014; – fresh authority to purchase Company's ordinary shares in order that the appropriate mechanisms are in place to enable the share buy-back programme to be reinstated at any time; and – authority would be exercised when, in the opinion of the Directors, the exercise of the authority would result in an increase in the Company's earnings per share and would be in the interest of its shareholders generally.
Proposed authority to purchase shares[1]	– the minimum price that may be paid for such shares is 25p; and – the maximum price is an amount equal to 105% of the average of the middle market prices shown in the quotation for an ordinary share as derived from the London Stock Exchange Daily Official List for the five business days immediately preceding the day on which the ordinary share is contracted to be purchased.
Treasury shares	– in accordance with the Company's policy, any repurchased shares are expected to be held as treasury shares; – at 31 December 2016 the number of treasury shares was 162,645,590 (2015: 162,645,590); – no dividends are paid on treasury shares; – treasury shares have no voting rights; and – treasury shares may be resold at a later date.

Note:
1. Further details see the Notice of Annual General Meeting which is made available to all shareholders and is also published on www.bat.com.

Stock market listings

British American Tobacco p.l.c.	Stock exchange	Details	Registrar/Transfer Office
Premium listing 31 Dec 2016: 1,769,948,816 ordinary shares (being 86.21% of issued share capital – excluding treasury shares) on main register.	London Stock Exchange (LSE) main market since 8 September 1998	Share Code: BATS ISIN: GB0002875804	Main register: Computershare Investor Services plc Bristol, UK
Secondary listing 31 Dec 2016: 257,070,692 ordinary shares (being 13.79% of issued share capital – excluding treasury shares) on branch register.	JSE Limited (JSE), South Africa since 28 October 2008	Abbreviated name: BATS Trading code: BTI	Branch register: Computershare Investor Services Proprietary Limited Johannesburg, South Africa
American Depositary Receipts (ADRs) 31 Dec 2016: 32,075,503 ADRs outstanding, representing 64,151,006 ordinary shares.	NYSE MKT Level II ADR programme The Company currently has unlisted trading privileges for the ADR programme and none of its securities are listed on any United States securities exchange or registered pursuant to the securities laws of the United States; the Company is subject to neither the NYSE MKT listing standards nor the corporate governance rules under the Sarbanes-Oxley Act of 2002.[1 2]	Symbol: BTI CUSIP Number: 110448107 From 14 February 2017, each ADR represents one ordinary share. Prior to that date each ADR represented two ordinary shares.	Sponsor/Depositary: Citibank, N.A. New York, USA

Note:
1. The Board has chosen, in the interests of good governance, to make a voluntary statement explaining the principal differences and common areas between the Company's corporate governance practices and those that would be required if the Company were subject to those rules. The statement is available at www.bat.com/governance.
2. In connection with the proposed merger with Reynolds American Inc., the Company's unlisted trading privileges will cease and its ordinary shares, represented by Level III ADRs, will be registered with the Securities and Exchange Commission.

Change of control provisions as at 31 December 2016

Significant agreement	Long-term incentive plans
Revolving credit facility agreement dated 29 May 2014: the Company, B.A.T. International Finance p.l.c., British American Tobacco Holdings (The Netherlands) B.V. and B.A.T. Netherlands Finance B.V. (as borrowers and, in the case of the Company, as a borrower and guarantor) and HSBC Bank plc (as agent) and certain financial institutions (as lenders) pursuant to which the lenders agreed to make available to the borrowers £3 billion for general corporate purposes (the 'Facility'). **Key provisions** – should a borrower (other than the Company) cease to be a direct or indirect subsidiary of the Company, such borrower shall immediately repay any outstanding advances made to it; – where there is a change of control in respect of the Company, the lenders can require all amounts outstanding under the Facility to be repaid.	The rules of the long-term incentive plans 2007 and 2016 (the LTIPs). **Key provisions** – in the event of a change of control of the Company as a result of a takeover, reconstruction or winding-up of the Company (not being an internal reorganisation), LTIP awards will become exercisable for a limited period based on the period of time that has elapsed since the date of the award and the achievement of the performance conditions at that date, unless the Remuneration Committee determines this not to be appropriate in the circumstances; – the rules of the LTIPs allow (as an alternative to early release) that participants may, if permitted, exchange their LTIP awards for new awards of shares in the acquiring company on a comparable basis.

Other corporate disclosures continued

Directors: interests and indemnities

Contracts and letters of appointment	– details of Directors' contracts and letters of appointment, remuneration and emoluments, and their interests in the Company's shares (including share options and deferred shares) as at 31 December 2016 are given in the Remuneration Report; and – no Director had any material interest in a contract of significance (other than a service contract) with the Company or any subsidiary company during the year.
Insurance	– appropriate cover provided in the event of legal action against the Company's Directors.
Indemnities	– provision of indemnities to Directors in accordance with the Company's Articles of Association and to the maximum extent permitted by law; and – as at the date of this report, such indemnities are in force covering any costs, charges, expenses or liabilities that they may incur in or about the execution of their duties to the Company or to any entity which is an associated company (as defined in Section 256 of the Companies Act 2006), or as a result of duties performed by them on behalf of the Company or any such associated company.

Directors: information and advice

Information: Board and committees	– receive papers for review in good time ahead of each meeting; – Company Secretary ensures good information flow within the Board and its Committees, and between the Non-Executive Directors and senior management; and – Company Secretary advises the Board on all governance matters.
Advice	– all Directors have access to the advice and services of the Company Secretary; – procedure is in place for all Directors to take independent professional advice at the Company's expense if required; and – each of the three principal Committees of the Board may obtain independent legal or other professional advice, at the Company's expense, and secure attendance at meetings of outsiders if needed.

Articles of Association

The Company is incorporated under the name of British American Tobacco p.l.c. and is registered in England and Wales under registered number 3407696. Under the Companies Act 2006, the Company's objects are unrestricted.
The following descriptions summarise certain provisions of the Company's current Articles of Association (the 'Articles') (as adopted by special resolution at the AGM on 28 April 2010), applicable English law and the Companies Act 2006 (the 'Companies Act'). This summary is qualified in its entirety by reference to the Companies Act and the Articles, available on www.bat.com.

Share capital – structure
Ordinary shares
– all of the Company's ordinary shares are fully paid
– no further contribution of capital may be required by the Company from the holders of such shares
Alteration of share capital – the Company by ordinary resolution may:
– consolidate and divide all or any of its shares into shares of a larger amount than its existing shares
– divide or sub-divide any of its shares into shares of smaller amount than its existing shares
– determine that, as between the shares resulting from such a sub-division, any of them may have any preference or advantage as compared with the others
Alteration of share capital – the Company, subject to the provisions of the Companies Act, may:
– reduce its share capital, its capital redemption reserve and any share premium account in any way
– purchase its own shares, including redeemable shares, and may hold such shares as treasury shares or cancel them
Dividend rights
– shareholders may, by ordinary resolution, declare dividends but not in excess of the amount recommended by the Directors
– the Directors may pay interim dividends out of distributable profits
– no dividend shall be paid otherwise than out of the profits available for distribution as specified under the provisions of the Companies Act
– the Directors may, with the authority of an ordinary resolution of the shareholders, pay scrip dividends or satisfy the payment of a dividend by the distribution of specific assets
– unclaimed dividends for a period of 12 years may be forfeited and cease to be owed by the Company
– specific provisions enable the Directors to elect to pay dividends by bank or electronic transfer only

Share capital – voting rights

Voting at general meetings

- by a show of hands, unless a poll is demanded
- on a show of hands, every shareholder who is present in person at a general meeting has one vote regardless of the number of shares held by the shareholder
- every proxy appointed by a shareholder and present at a general meeting has one vote except that if the proxy has been duly appointed by more than one shareholder entitled to vote on the resolution and is instructed by one or more of those shareholders to vote for the resolution and by one or more others to vote against it, or is instructed by one or more of those shareholders to vote in one way and is given discretion as to how to vote by one or more others (and wishes to use that discretion to vote in the other way) he has one vote for and one vote against the resolution
- on a poll, every shareholder who is present in person or by proxy has one vote for every share held by the shareholder
- a shareholder (or his duly appointed proxy) entitled to more than one vote need not use all his votes or cast all the votes he uses in the same way
- a poll may be demanded by any of the following:

  (1) the Chairman of the meeting;
  (2) the Directors;
  (3) not less than five shareholders having the right to vote at the meeting;
  (4) a shareholder or shareholders representing not less than one-tenth of the total voting rights of all shareholders having the right to vote at the meeting (excluding any voting rights attached to treasury shares); or
  (5) a shareholder or shareholders holding shares which confer a right to vote on the resolution at the meeting being shares on which an aggregate sum has been paid up equal to not less than one-tenth of the total sum paid up on all shares conferring that right (excluding any voting rights attached to treasury shares)

Matters transacted at general meetings

- ordinary resolutions: can include resolutions for the appointment, reappointment and removal of Directors, the receiving of the Annual Report, the declaration of final dividends, the appointment and reappointment of the external auditor, the authority for the Company to purchase its own shares and the grant of authority to allot shares
- an ordinary resolution is passed when a simple majority of the votes cast at a meeting at which there is a quorum vote in favour of the resolution
- special resolutions can include resolutions amending the Company's Articles and resolutions relating to certain matters concerning a winding-up of the Company
- a special resolution is passed when not less than three-quarters of the votes cast at a meeting at which there is a quorum vote in favour of the resolution
- quorum for a meeting of the Company: this is a minimum of two shareholders present in person or by proxy or by a duly authorised representative(s) of a corporation which is a shareholder and entitled to vote
- convening a meeting: the Company may specify a time not more than 48 hours before the time of the meeting (excluding any part of a day that is not a working day) by which a person must be entered on the register of members in order to have the right to attend or vote at the meeting

Share capital – pre-emptive rights and new issues of shares

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

Restrictions on transfers of shares

- Directors can, in their absolute discretion, refuse to register the transfer of a share in certificated form which is not fully paid, provided that such a refusal would not prevent dealings in shares in certificated form which are not fully paid from taking place on a proper basis
- The Directors may also refuse to register a transfer of a share in certificated form (whether fully paid or not) unless the instrument of transfer:

  (1) is lodged, duly stamped, and is deposited at the registered office of the Company or such other place as the Directors may appoint and is accompanied by a certificate for the shares to which it relates and such other evidence as the Directors may reasonably require to show the right of the transferor to make the transfer;
  (2) is in respect of only one class of share; and
  (3) is in favour of not more than four transferees
- for uncertificated shares, transfers shall be registered only in accordance with the terms of the Uncertificated Securities Regulations 2001 so that Directors may refuse to register a transfer which would require shares to be held jointly by more than four persons
- if the Directors refuse to register a share transfer, they must give the transferee notice of this refusal as soon as practicable and in any event within two months of the instrument of transfer being lodged with the Company

Other corporate disclosures continued

Repurchase of shares

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

Directors

Appointment and retirement

- a Board of Directors of not fewer than five Directors and not subject to any maximum (unless otherwise determined by ordinary resolution of shareholders)
- Directors and the Company (by ordinary resolution) may appoint a person who is willing to act as a Director
- the Articles govern minimum number of Directors who must be subject to retirement at each AGM and who may seek re-election
- notwithstanding the Articles, all of the Directors of the Company will be subject to re-election at the forthcoming AGM to be held on 26 April 2017 in accordance with the UK Corporate Governance Code
- fees for Non-Executive Directors and the Chairman are determined by the Directors but cannot currently exceed in aggregate an annual sum of £2,500,000, unless determined otherwise by ordinary resolution of the shareholders
- the remuneration of the Executive Directors is determined by the Remuneration Committee, which comprises independent Non-Executive Directors

Disclosure of interests

- specific provisions apply to the regulation and management of the disclosure of Directors' interests in transactions and any conflicts of interest that may occur in such situations including those which may arise as a result of the Director's office or employment or persons connected with him or her

Meetings and voting

- the quorum for a meeting of Directors is two Directors
- the Directors may delegate any of their powers to a person or a committee
- the Articles place a general prohibition on a Director voting at a Board meeting on any matter in which he has an interest other than by virtue of his interest in shares in the Company
- specific provisions apply to a Director's ability to vote in relation to: the giving of guarantees; the provision of indemnities; insurance proposals; retirement benefits; and transactions or arrangements with a company in which the Director may have an interest

Borrowing powers

- the Directors may exercise all the powers of the Company to borrow money and to mortgage or charge its undertaking, property, assets (present and future) and uncalled capital
- the Directors may also issue debentures, debenture stock and other securities

The Strategic Report and the Directors' Report comprised in this Annual Report have been approved and are signed by order of the Board by:

Nicola Snook
Secretary
22 February 2017

Governance

Responsibility of Directors

Statement of Directors' responsibilities in respect of the Annual Report and the financial statements

The Directors are responsible for preparing the Annual Report and both the Group and the Company financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare group and parent company financial statements for each financial year. Under that law they are required to prepare the Group financial statements in accordance with IFRS as adopted by the EU and applicable law and have elected to prepare the Company financial statements in accordance with UK Accounting Standards, including FRS 101 Reduced Disclosure Framework.

Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and the Company and of their profit or loss for the financial year. In preparing the Group and the Company financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- for the Group financial statements, state whether they have been prepared in accordance with IFRS as adopted by the EU;
- for the Company financial statements, state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the Company financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Group and the Company will continue in business.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that its financial statements comply with the Companies Act 2006. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and in that context, having proper regard to the establishment of appropriate systems of internal control, to prevent and detect fraud and other irregularities.

Under applicable law and regulations, the Directors are also responsible for preparing a Strategic Report, Directors' Report, Directors' Remuneration Report and Corporate Governance Statement that complies with that law and those regulations.

The Directors are responsible for the maintenance and integrity of the Annual Report included on the Company's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Directors' declaration in relation to relevant audit information

Having made appropriate enquiries, each of the Directors who held office at the date of approval of this Annual Report confirms that:

- to the best of his or her knowledge and belief, there is no relevant audit information of which the Company's auditors are unaware; and
- he or she has taken all steps that a Director might reasonably be expected to have taken in order to make himself or herself aware of relevant audit information and to establish that the Company's auditors are aware of that information.

Responsibility statement of the Directors in respect of the annual financial report

We confirm that to the best of our knowledge:

- the financial statements, prepared in accordance with the applicable set of accounting standards, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company and the undertakings included in the consolidation taken as a whole; and
- the Strategic Report and Directors' Report include a fair review of the development and performance of the business and the position of the Company and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face.

We consider the Annual Report and Accounts, taken as a whole, is fair, balanced and understandable and provides information necessary for shareholders to assess the Company's position and performance, business model and strategy.

This responsibility statement has been approved and is signed by order of the Board by:

Richard Burrows
Chairman

Ben Stevens
Finance Director

22 February 2017

British American Tobacco p.l.c.
Registered in England and Wales No. 3407696

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.

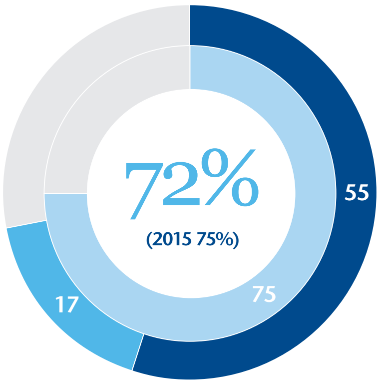
Independent auditor's report continued

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.

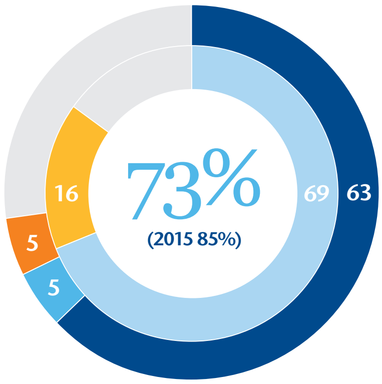
Specified risk-focused audit procedures have been performed at a corporate level by the engagement team in London in relation to the Group consolidation and associated journal entries and financial statement disclosures. Additionally, supplemental procedures over and above those reported by component 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:

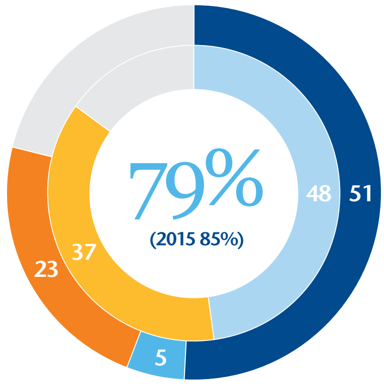
Group revenue



Group profit before tax



Group total assets



- Full scope for Group audit purposes 2016
- Audit of one or more account balances 2016
- Specified risk-focused audit procedures 2016
- Full scope for Group audit purposes 2015
- Audit of one or more account balances 2015
- Specified risk-focused audit procedures 2015
- Residual components

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 £m	2015 £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	Share capital £m	Share premium, capital redemption and merger reserves £m	Other reserves £m	Retained earnings £m	Total attributable to owners of parent £m	Non-controlling interests £m	Total equity £m
		Attributable to owners of the parent						
Balance at 1 January 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	Share capital £m	Share premium, capital redemption and merger reserves £m	Other reserves £m	Retained earnings £m	Total attributable to owners of parent £m	Non-controlling interests £m	Total equity £m
		Attributable to owners of the parent						
Balance at 1 January 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.

Financial Statements

Group Balance Sheet
At 31 December

	Notes	2016 £m	2015 £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

Financial Statements

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.

Notes on the Accounts continued

1 Accounting policies continued

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.

1 Accounting policies continued

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.

Notes on the Accounts continued

1 Accounting policies continued

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.

1 Accounting policies continued

Adjusting items

Adjusting items are significant items in the profit from operations, net finance costs, taxation and the Group's share of the post-tax results of associates and joint ventures which individually or, if of a similar type, in aggregate, are relevant to an understanding of the Group's underlying financial performance. While the disclosure of adjusting items is not required by IFRS, these items are separately disclosed either as memorandum information on the face of the income statement and in the segmental analyses, or in the notes to the accounts as appropriate.

The Group believes that these items are useful to users of the Group financial statements in helping them to understand the underlying business performance and are used to derive the Group's principal non-GAAP 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.

Notes on the Accounts continued

2 Segmental analyses

As the chief operating decision maker, the Management Board reviews external revenues and adjusted profit from operations to evaluate segment performance and allocate resources 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 £m	Translation exchange £m	Revenue Current rates £m	Revenue £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 £m	Translation exchange £m	Adjusted* segment result Current rates £m	Adjusting items £m	Segment result Current rates £m	Adjusted* segment result £m	Adjusting items £m	Segment result £m
Asia-Pacific	1,488	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.

2 Segmental analyses continued

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 £m	Translation exchange £m	Adjusted depreciation, amortisation and impairment Current rates £m	Adjusting items £m	Depreciation, amortisation and impairment Current rates £m	Adjusted depreciation, amortisation and impairment £m	Adjusting items £m	Depreciation, amortisation and impairment £m
Asia-Pacific	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	
Revenue is based on location of sale	2016 £m	2015 £m	2016 £m	2015 £m	2016 £m	2015 £m
External revenue	272	190	14,479	12,914	14,751	13,104

	United Kingdom		All foreign countries		Group	
	2016 £m	2015 £m	2016 £m	2015 £m	2016 £m	2015 £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.

Notes on the Accounts continued

3 Profit from operations

(a) Employee benefit costs

	2016 £m	2015 £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 £m	2015 £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 £m	2015 £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).

3 Profit from operations continued

(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 £m	2015 £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.

Notes on the Accounts continued

4 Net finance costs/(income)

(a) Net finance costs/(income)

	2016 £m	2015 £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 Total £m	2016 Group's share £m	2015 Total £m	2015 Group's share £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.

Notes on the Accounts continued

5 Associates and joint ventures continued

(b) Master Settlement Agreement continued

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 Group's share £m	2015 Group's share £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 £m	ITC £m	Others £m	Total £m	Reynolds American £m	ITC £m	Others £m	Total £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 £m	2015 £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.

Notes on the Accounts continued

6 Taxation on ordinary activities continued

(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 £m	2015 £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 £m	**Weighted average number of shares m**	**Earnings per share pence**	Earnings £m	Weighted average number of shares m	Earnings per share pence
Basic earnings per share (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 £m**	**Earnings per share pence**	Earnings £m	Earnings per share pence	**Earnings £m**	**Earnings per share pence**	Earnings £m	Earnings per share pence
Unadjusted earnings per share		**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

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Notes on the Accounts continued

7 Earnings per share continued

Headline earnings per share as required by the JSE Limited

The presentation of headline earnings per share, as an alternative measure of earnings per share, is mandated under the JSE Listing Requirements. It is calculated in accordance with Circular 2/2016 '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 £m	**Earnings per share pence**	Earnings £m	Earnings per share pence	**Earnings £m**	**Earnings per share pence**	Earnings £m	Earnings per share pence
Unadjusted earnings per share	**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* £m	Computer software £m	Trademarks and similar intangibles £m	Assets in the course of development £m	Total £m	Goodwill* £m	Computer software £m	Trademarks and similar intangibles £m	Assets in the course of development £m	Total £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.

Notes on the Accounts continued

9 Intangible assets continued

Impairment testing for intangible assets with indefinite lives including goodwill continued

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 £m	Pre-tax discount rate %	Carrying amount £m	Pre-tax discount rate %
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 £m	Leasehold property £m	Plant and equipment £m	Assets in the course of construction £m	Total £m	Freehold property £m	Leasehold property £m	Plant and equipment £m	Assets in the course of construction £m	Total £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 £m	2015 £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

Notes on the Accounts continued

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

11 Investments in associates and joint ventures continued

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 £m	2015 £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.

Notes on the Accounts continued

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.

12 Retirement benefit schemes continued

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 £m	2015 £m	2016 £m	2015 £m	2016 £m	2015 £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 £m	2015 £m	2016 £m	2015 £m	2016 £m	2015 £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.

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12 Retirement benefit schemes continued

The amounts recognised in the income statement are as follows:

	Pension schemes		Healthcare schemes		Total	
	2016 £m	2015 £m	**2016 £m**	2015 £m	**2016 £m**	2015 £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 £m	2015 £m	**2016 £m**	2015 £m	**2016 £m**	2015 £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 £m	2015 £m	**2016 £m**	2015 £m	**2016 £m**	2015 £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.

12 Retirement benefit schemes continued

The movements in funded scheme assets are as follows:

	Pension schemes		Healthcare schemes		Total	
	2016 £m	2015 £m	**2016 £m**	2015 £m	**2016 £m**	2015 £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 £m	2015 £m	**2016 £m**	2015 £m	**2016 £m**	2015 £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 £m	2015 £m	**2016 £m**	2015 £m	**2016 £m**	2015 £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)

Notes on the Accounts continued

12 Retirement benefit schemes continued

The principal actuarial assumptions (weighted to reflect individual scheme differences) used in the following principal countries are 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 £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	**228**	**(227)**		
Rate of inflation – increase/(decrease) of scheme liabilities			**213**	**(199)**
Discount rate – (decrease)/increase of scheme liabilities			**(256)**	**273**

12 Retirement benefit schemes continued

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 £m	Excess of capital allowances over depreciation £m	Tax losses £m	Undistributed earnings of associates and subsidiaries £m	Retirement benefits £m	Fair value losses/ (gains) £m	Other temporary differences £m	Total £m
At 1 January 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.

Notes on the Accounts continued

14 Trade and other receivables

	2016 £m	2015 £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 £m	2015 £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 £m	2015 £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 £m	2015 £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 £m	2015 £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 £m	Liabilities £m	Assets £m	Liabilities £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.

Notes on the Accounts continued

16 Derivative financial instruments continued

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 £m	Outflow £m	Inflow £m	Outflow £m	Inflow £m	Outflow £m	Inflow £m	Outflow £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 £m	Liabilities Outflow £m	Assets Inflow £m	Liabilities Outflow £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.

Financial Statements

Notes on the Accounts continued

19 Capital and reserves – reconciliation of movement in total equity

	Attributable to owners of the parent						
	Share capital £m	Share premium, capital redemption and merger reserves £m	Other reserves £m	Retained earnings £m	Total attributable to owners of the parent £m	Non-controlling interests £m	Total equity £m
1 January 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**

19 Capital and reserves – reconciliation of movement in total equity continued

	Attributable to owners of the parent						
	Share capital £m	Share premium, capital redemption and merger reserves £m	Other reserves £m	Retained earnings £m	Total attributable to owners of the parent £m	Non-controlling interests £m	Total equity £m
1 January 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.

Notes on the Accounts continued

19 Capital and reserves – reconciliation of movement in total equity continued

(a) Share premium account, capital redemption reserves and merger reserves comprise:

	Share premium account £m	Capital redemption reserves £m	Merger reserves £m	Total £m
1 January 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.

(b) Information on the principal components of non-controlling interests is provided in note 29.

19 Capital and reserves – reconciliation of movement in total equity continued

Movements in other reserves and retained earnings (which are after deducting treasury shares) shown above comprise:

	Translation reserve £m	Hedging reserve £m	Available-for-sale reserve £m	Revaluation reserve £m	Other £m	Total other reserves £m	Retained earnings: Treasury shares £m	Retained earnings: Other £m
1 January 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

Financial Statements

Notes on the Accounts continued

19 Capital and reserves – reconciliation of movement in total equity continued

	Translation reserve £m	Hedging reserve £m	Available-for-sale reserve £m	Revaluation reserve £m	Other £m	Total other reserves £m	Retained earnings: Treasury shares £m	Retained earnings: Other £m
1 January 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.

19 Capital and reserves – reconciliation of movement in total equity continued

Other reserves comprise:

(a) £483 million which arose in 1998 from merger accounting in a Scheme of Arrangement and Reconstruction whereby British American Tobacco p.l.c. acquired the entire share capital of B.A.T Industries p.l.c. and the share capital of that company's principal financial services subsidiaries was distributed, so effectively demerging them; and

(b) In the Rothmans transaction, convertible redeemable preference shares were issued as part of the consideration. The discount on these shares was amortised by crediting other reserves and charging retained earnings. The £90 million balance in other reserves comprises the accumulated balance in respect of the preference shares converted during 2004.

The tax attributable to components of other comprehensive income is as follows:

	2016 £m	2015 £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 £m	2015 £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.

Notes on the Accounts continued

20 Borrowings continued

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 2016 £m	Per balance sheet 2015 £m	Contractual gross maturities 2016 £m	Contractual gross maturities 2015 £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 £m	US dollar £m	UK sterling £m	Euro £m	Canadian dollar £m	Other currencies £m	Total £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 £m	Between 1-2 years £m	Between 2-3 years £m	Between 3-4 years £m	Between 4-5 years £m	Beyond 5 years £m	Total £m
31 December 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.

20 Borrowings continued

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 £m	2015 £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 £m	Employee related benefits £m	Fox River £m	Other provisions £m	Total £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.

Notes on the Accounts continued

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.

23 Financial instruments and risk management continued

Liquidity risk continued

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.

Notes on the Accounts continued

23 Financial instruments and risk management continued

Interest rate risk continued

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.

23 Financial instruments and risk management continued

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 £m	Level 2 £m	Level 3 £m	Total £m	Level 1 £m	Level 2 £m	Level 3 £m	Total £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* £m	Related amounts not offset in the Group balance sheet £m	Net amount £m	Amount presented in the Group balance sheet* £m	Related amounts not offset in the Group balance sheet £m	Net amount £m
Financial Assets						
– Derivative Financial Instruments (note 16)	**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.

Notes on the Accounts continued

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 £m	Cash-settled £m	Equity-settled £m	Cash-settled £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 £m	Unvested £m	Vested £m	Unvested £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

Notes on the Accounts continued

25 Share-based payments continued

(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

25 Share-based payments continued

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.

Notes on the Accounts continued

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 £m	2015 £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.

Notes on the Accounts continued

28 Contingent liabilities and financial commitments continued

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		
	31 December 2015	2,995		
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 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.

28 Contingent liabilities and financial commitments continued

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.

Notes on the Accounts continued

28 Contingent liabilities and financial commitments continued

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.
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.

28 Contingent liabilities and financial commitments continued

Nigria

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.

Notes on the Accounts continued

28 Contingent liabilities and financial commitments continued

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.

28 Contingent liabilities and financial commitments continued

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.

Notes on the Accounts continued

28 Contingent liabilities and financial commitments continued

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.

28 Contingent liabilities and financial commitments continued

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.

Notes on the Accounts continued

28 Contingent liabilities and financial commitments continued

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 £m	Malaysia Group 2015 £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.

Notes on the Accounts continued

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.

Group companies and undertakings

This disclosure is made in accordance with Section 409 of the Companies Act 2006 and The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008, as amended by The Companies, Partnerships and Groups (Accounts and Reports) Regulations 2015. A full list of subsidiary undertakings, associates and joint ventures and joint operations as defined by IFRS (showing the country of incorporation, effective percentage of equity shares held and full registered office addresses) as at 31 December 2016 is disclosed below.

The subsidiary undertakings that are held directly by British American Tobacco p.l.c. (the ultimate parent company) are indicated thus*; all others are held by sub-holding companies.

Unless otherwise stated, the equity shares held are in the form of ordinary shares or common stock, except for those indicated thus#, which include preference shares. The effective percentage of equity shares held in subsidiary undertakings is 100% unless otherwise stated. Further, where the effective percentage of equity shares held by the sub-holding company is different from that held by British American Tobacco p.l.c., the percentage of equity shares held by British American Tobacco p.l.c. is indicated thus^ and is shown after the percentage interest held by the sub-holding company.

The results of a number of these subsidiary undertakings principally affect the financial statements of the Group. These principal subsidiary undertakings are highlighted in blue and are considered to be the main corporate entities in those countries which, in aggregate, contributed over 80% of the Group revenue and profit from operations.

Subsidiary Undertakings

Albania

Rruga e Kavajes, Ish Kombinati Ushqimor, Tirana, Albania

British American Tobacco - Albania SH.P.K.

Algeria

Industrial Zone, Cheraga, El Omrane, Ouled Fayet Road, Lot 04 Ilot 789, Algiers, Algeria

British American Tobacco (Algérie) S.P.A. (51%)

Angola

Viana Park, Polo Industrial, Viana, Luanda, Angola

Agrangol Limitada (77%)

British American Tobacco - B.A.T. Angola, Limitada [i]

Fabrica de Tabacos de Cacuso (51%)

SETA, Sarl (98%)

Sociedade Geral de Distribuição e Comércio, Limitada

Sociedade Industrial Tabacos Angola LDA (76.60%)

Sociedade Unificada Tabacos Angola LDA (76.30%)

Argentina

San Martín 140, Floor 14, City of Buenos Aires, Argentina

British American Tobacco Argentina S.A.I.C.y F. (99.95%)

Australia

166 William Street, Woolloomooloo, NSW 2011, Australia

American Cigarette Company (Overseas) Pty. Limited

B.A.T Australia Pty. Limited

British American Tobacco (Australasia Holdings) Pty Limited

British American Tobacco Australasia Limited

British American Tobacco Australia Limited

British American Tobacco Australia Overseas Pty Limited

British American Tobacco Australia Services Limited

British American Tobacco Australia Superannuation Pty Limited

British American Tobacco Australia Vending Limited

British American Tobacco Manufacturing Australia Pty Ltd.

British American Tobacco South Pacific Exports Limited

Carreras Proprietary Limited

Granville Tobacco Processors Pty. Limited

Martins of Piccadilly Pty Ltd

Nicovations Australia Pty Limited

Rothmans Asia Pacific Limited #

T.A. Field Pty Limited

The Benson & Hedges Company Pty. Limited

The Nelson Tobacco Manufacturing Corporation Pty. Ltd

W.D. & H.O. Wills Holdings Limited

Wills (Pagewood) Pty Limited

Austria

Dr. Karl Lueger Platz 5, 1010, Wien, Austria

British American Tobacco (Austria) GmbH

Bahrain

Unit 1, Building 2126, Road 1734, Block 117, Hidd Town, Bahrain

British American Tobacco Middle East S.P.C.

Bangladesh

New DOHS Road, Mohakhali, Dhaka 1206, Bangladesh

British American Tobacco Bangladesh Company Limited (72.91%)

Barbados

Braemar Court, Deighton Road, St, Michael, Barbados

B.C.O., Inc

Chancery Chambers, Chancery House, High Street, Bridgetown, Barbados

Southward Insurance Ltd.

Belarus

7th Floor, 3 Kuprevicha Str., Minsk, 220141, Belarus

British-American Tobacco Trading Company Foreign Private Trading Unitary Enterprise

Belgium

Globe House, 4 Temple Place, WC2R 2PG, London, United Kingdom

British American Tobacco Holdings Belgium N.V.

Nieuwe Gentsesteenweg 21, 1702 Groot-Bijgaarden, Belgium

British American Tobacco Belgium S.A.

Tabacofina-Vander Elst N.V.

Rue de Koninck 38, 1080 Sint-Jans-Molenbeek, Belgium

British American Tobacco Co-ordination Centre/L.P. Co-ordination Centre VOF

Benin

Cotonou, Lot Numbero H19, Quartiers Les Cocotiers, 01 BP 2520, Benin

British American Tobacco Benin SA

Bosnia and Herzegovina

Fra Dominka Mandića 24 A, 88220 Široki Brijeg, Bosnia and Herzegovina

IPRESS d.o.o. (51%) (49.70%) ^

Ulica Carice Milice br. 11, 78000 Banja Luka, Bosnia and Herzegovina

British American Tobacco - BAT - BL d.o.o.

ul. Azize Šaćirbegović 1, 71000 Sarajevo-Novo Sarajevo, Bosnia and Herzegovina

TDR d.o.o. Sarajeva

ul. Kolodvorska 12, 71000 Sarajevo-Novo Sarajevo, Bosnia and Herzegovina

iNovine BH d.o.o. (100%) (97.45%) ^

Opresa d.d. (97.45%)

Financial Statements

Group companies and undertakings continued

Botswana

Plot 64518, Fairgrounds, Office Park, Gaborone, Botswana

British American Tobacco Botswana (Pty) Limited

Business Venture Investments Botswana 6773 (Pty) Ltd.

Brazil

Rua Candelaria 66, Rio de Janeiro, Brazil

Yolanda Participacoes S.A.

Rua Candelaria 66, Salas 101 a 1201, Rio de Janeiro, Brazil

Souza Cruz LTDA

Brunei Darussalam

6th Floor, Bang Hj Ahmad Laksamana Othman, 38-39, Jalan Sultan, Bandar Seri Begawan BS8811, Brunei Darussalam

Commercial Marketers and Distributors Sdn. Bhd. (100%) (50%) ^

Bulgaria

115 M, Tsarigradsko Shose Blvd., Building D, Floor 5, Sofia, Mladost Municipality, 1784, Bulgaria

British American Tobacco Trading EOOD

Cambodia

1121 National Road 2, Prek Tanou Village, Sangkat Chak Ang Re Leu, Khan Mean Chey, Phnom Penh, Kingdom of Cambodia

British American Tobacco (Cambodia) Limited (71%)

No.33, Street No. 294 (Corner of Street No. 29), Sangkat Tonle Bassac, Khan Cham Karmon, Phnom Penh, Cambodia

British American Tobacco (Cambodge) International Limited

Cameroon

Rue Njo Njo, Bonapriso - B.P. 259, Douala, Cameroon

British American Tobacco Cameroun S.A. (99.75%)

Canada

3711 St-Antoine West, Montreal, Quebec, H4C 3P6, Canada

Allan Ramsay and Company Limited

Cameo Inc.

Construction Romir Inc.

Genstar Corporation (ii)

Imperial Brands Limited

Imperial Tobacco Canada Limited

Imperial Tobacco Company Limited

Imperial Tobacco Products Limited

Imperial Tobacco Services Inc.

John Player & Sons Ltd

Liggett & Myers Tobacco Company of Canada Limited (iii)

Marlboro Canada Limited

Medaillon Inc.

2004969 Ontario Inc.

Chile

Isidora Goyenechea 3000, piso 19, Las Codes, Chile

BAT Chile S.A. (100%) (99.41%) ^

British American Tobacco Chile Operaciones S.A. (99.50%)

Inversiones Casablanca S.A.

China

Unit 1001 in 901, 9/F, Building 3, No.8 Guanghuadongli, Chaoyang District Beijing, People's Republic of China

British American Consulting (Beijing) Ltd

Colombia

Av. Cra. 72 # 80-94 Piso 10. Bogotá, Colombia

British American Tobacco Colombia S.A.S.

Vype Colombia S.A.S.

Congo (Democratic Republic of)

149, A&B Boulevard du 30 Juin, Gombe, Kinshasa, Democratic Republic of Congo

BAT Services Congo SARL

1er étage, Immeuble du Centenaire, Gombe, Kinshasa, Democratic Republic of Congo

BAT Distribution SARL

British American Tobacco Congo SARL

Costa Rica

325 Metros este del Puente de la Firestone, Llorente, Flores, Heredia, Costa Rica

BASS Americas S.A.

BATCCA Park Inversiones Immobiliarias, S.A.

BATCCA Servicios S.A.

Croatia

Draškovićeva 27, 10000 Zagreb, Croatia

Inovine d.d. (88.80%)

Ivana Lučića 2/a, 10000 Zagreb, Croatia

BAT HRVATSKA d.o.o.

Bonaster d.o.o.

Obala V. Nazora 1, 52210 Rovin, Croatia

Adiste d.o.o.

Istagratika d.d. Cardboard Packaging Production

TDR d.o.o.

Osječka 2, 33000 Virovitica, Croatia

Hrvatski Duhani d.d. Tobacco Leaf Processing (89.55%)

Cuba

Calle San Jose y Princesa, Municipio 10 de Octubre, Ciudad de La Habana, Cuba

Brascuba Cigarrillos S.A. (50%) (37.63%) ^

Cyprus

Photiades Business Centre, 5th Floor, 8 Stasinou Avenue, Nicosia, CY-1060, Cyprus

B.A.T (Cyprus) Limited

Carreras of Cyprus (Export) Limited

Rothmans (Middle East) Limited

Rothmans Distribution Services Limited

Rothmans of Pall Mall (Cyprus) Limited

Czech Republic

Karolinská 654/2, Prague 8 – Karlín, 186 00, Czech Republic

British American Tobacco (Czech Republic), s.r.o.

Denmark

Vester Farimagsgade 16, 1606 Copenhagen, Denmark

British American Tobacco Denmark A/S (House of Prince A/S)

Precis (1789) Denmark A/S

Djibouti

B.P. 2392, Djibouti

Tobacco Exporters International (Mer Rouge) SARL

Rue de Magadiscio, Lot No. 133, Djibouti City, Djibouti

British American Tobacco Djibouti SARL

Egypt

10 Omar Ibn El Khattab St. City Stars Complex, Star Capital Towers 4A, 8th floor, Heliopolis, Cairo, Egypt

BETCO for General Services and Marketing LLC

BETCO for Trade and Distribution LLC

British American Tobacco North Africa LLC

City Stars Complex, Star Capital 4A, 10th Floor, Omar Ibn El Khattab St., Heliopolis, Cairo, Egypt
British American Tobacco Egypt LLC
Plot No.33, Taqseem Al Marwaha, Qatameya, Nasr City, Cairo, Egypt
English American Company for Importation and Trade LLC

Eritrea
P.O. Box 749, 62 Ras Alula Street, Asmara, Eritrea
British American Tobacco (Eritrea) Share Company #

Estonia
Mustamäe Tee 46, 10621 Tallinn, Estonia
British American Tobacco Estonia AS

Ethiopia
Bole Road, TK Building 3rd Floor, Addis Ababa, Ethiopia
Tobacco Marketing Consultants

Fiji
Lady Maria Road, Nabua, Suva, Fiji
British American Tobacco (Fiji) Marketing Limited
Central Manufacturing Company Limited
Rothmans of Pall Mall (Fiji) Limited

Finland
Itamerentori 2, 00180, Helsinki, Finland
British American Tobacco Finland Oy

France
8 Rue La Boétie, 75008 Paris, France
Carreras France SAS
Cœur Défense Tour A 100-110 Esplanade de Gaulle 92932 Paris La Défense Cedex, France
British American Tobacco France SAS
France 23, rue du Roule, 75001 Paris, France
Nicoventures France S.A.S.

Germany
Alsterufer 4, 20354 Hamburg, Germany
BATIG Gesellschaft fur Beteiligungen m.b.H.
British American Tobacco (Germany) GmbH
British American Tobacco (Hamburg International) GmbH
British American Tobacco (Industrie) GmbH
TDR Germany GmbH Hamburg
Schillerstr. 10, 28195 Bremen, Germany
Chic Deutschland GmbH
Weiherstraße 26, 95448 Bayreuth, Germany
Batberg Cigarettenfabrik GmbH

Ghana
F190/5 Josiah Tongogari Street, Opposite Tante Marie Restaurant, Labone-Accra, Ghana
British American Tobacco Ghana Limited (97.09%)

Greece
27, Ag. Thoma Street, Maroussi, 151 24, Greece
British American Tobacco Hellas S.A.

Guernsey
St Martin's House, Le Bordage, St. Peter's Port, GY1 4AU, Guernsey
Belaire Insurance Company Limited

Guyana
90 Carmichael Street, South Cummingsburg, Georgetown, Guyana
Demerara Tobacco Company Limited (70.25%)

Honduras
Boulevard del Sur, Zona El Cacao, San Pedro Sula, Depart. de Cortés, Honduras
Tabacalera Hondureña S.A. (83.64%)

Hong Kong
11/F, One Pacific Place, 88 Queensway, Hong Kong
British American Tobacco China Investments Limited
16/F, Two International Finance Centre, 8 Finance Street, Central, Hong Kong
British American Tobacco Asia-Pacific Region Limited
British-American Tobacco Company (Hong Kong) Limited
Units 2501 and 2506 to 2510, 25/F Island Place Tower, Island Place 510, King's Road, Hong Kong
American Cigarette Company Limited
British Cigarette Company (1964) Limited

Hungary
H-1124, Budapest, Csörsz utca 49-51. 3. em., Hungary
BAT Pécsi Dohánygyár Kft.

Indonesia
Capital Place 6th Floor, Jl. Gatot Subroto Kav. 18, Jakarta 12710 Indonesia
PT Bentoel Internasional Investama, Tbk (92.48%) ^
Jl. Halmahera No. 98-100, Ciptomulyo, Sukun, Malang, Jawa Timur 65117 Indonesia
PT Lestariaputra Wirasejati (100%) (92.48%) ^
PT Pantura Tobacco (100%) (92.48%) ^
Jl. Ichwan Ridwan Rais No. 47, Tanjungrejo Sukun, Kotamadya Malang, Jawa Timur 65147 Indonesia
PT Bintang Boladunia (100%) (92.48%) ^
Jl. Niaga 4A, Ciptomulyo, Sukun, Malang, Jawa Timur 65148 Indonesia
PT Java Tobacco (100%) (92.48%) ^
Jl. Pulau Galang No. 2B, Ciptomulyo, Sukun, Kotamadya Malang, Jawa Timur 65148 Indonesia
PT Cipta Persona Bintang (100%) (92.48%) ^
PT Perusahaan Dagang Suburaman (100%) (92.48%) ^
Jl. Raya Karangduren RT 05/04, Desa Banjararum, Kecamatan Singosari, Kabupaten Malang, Jawa Timur 65162 Indonesia
PT Bintang Jagat Sejati (100%) (92.48%) ^
Jl. Raya Karanglo, Desa Banjararum, Kecamatan Singosari, Jawa Timur 65153 Indonesia
PT Amiseta (100%) (92.48%) ^
PT Bentoel Prima (iv) (100%) (92.48%) ^
PT Perusahaan Dagang dan Industri Tresno (100%) (92.48%) ^
Jl. Susanto No. 2B, Ciptomulyo, Sukun, Malang, Jawa Timur 65148 Indonesia
PT Bentoel Distribusi Utama (100%) (92.48%) ^

Iran, Islamic Republic of
No. 2 Saba Boulevard with Africa Boulevard, Tehran, 19667, Islamic Republic of Iran
B.A.T. Pars Company (Private Joint Stock) (99.90%)
Unit 09, Level 9, 114, Kaj Abadi Street Valiasr, Tehran, 1966916545, Islamic Republic of Iran
TDR Parisian Co

Iraq
Enkawa, Erbil, Kurdistan Region of Iraq
B.A.T. Iraqia Company for Tobacco Trading Limited

Group companies and undertakings continued

Ireland

The Greenhouse, 6th Floor, Block E, Mountainview, Leopardstown, Dublin, 18, Ireland

BAT Investments (Ireland) Limited

Carreras (Ireland) Limited

Carroll Group Distributors Limited

Murray Tobacco Limited (v)

P.J. Carroll & Company Limited (iv)

Rothmans of Pall Mall (Ireland) Limited (v)

William Ruddell Limited

Isle of Man

2nd Floor, St Mary's Court, 20 Hill Street, Douglas, IM1 1EU, Isle of Man

Abbey Investment Company Limited

The Raleigh Investment Company Limited

Tobacco Investments Limited

Tobacco Manufacturers (India) Limited

Israel

Yad Harutzim St. Siim Park Building ≠9E, P.O.Box 8811 Netanya South 42504, Israel

Overseas Tobacco Limited

Italy

Via Amsterdam 147, 00144 Rome, Italy

British American Tobacco Italia S.p.A.

Jamaica

13A Ripon Road, Kingston 5, Jamaica

Carreras Limited (50.44%) (x)

Cigarette Company of Jamaica Limited (100%) (50.40%) ^

Twickenham Park, Spanish Town, St. Catherine, Jamaica

Sans Souci Development Limited (100%) (50.40%) ^

Sans Souci Limited (100%) (50.40%) ^

Japan

Atago Mori Tower 21F, 2-5-1 Arago, Minato-Ku, Tokyo, 105-622, Japan

British American Tobacco Japan, Ltd.

Jersey

3rd Floor, 24 Hill Street, St Helier, JE2 4UA, Jersey

BAT (CI) Finance Limited

BAT (CI) Holdings Limited

British American Tobacco (CI) Limited

Inter-Euro Holdings (Jersey) Limited

Pathway 1 (Jersey) Limited

Pathway 2 (Jersey) Limited #

Pathway 4 (Jersey) Limited

Pathway 5 (Jersey) Limited

Jordan

Salman Quadah Street, Behind Abdoun Mall Opp. Khaled Khreisat Complex, Villa No. (1), Abdoun, Amman, Jordan

British American Tobacco – Jordan Private Shareholding Company Limited (xii)

Kazakhstan

Kazybek bi 20 A, Almaty, Republic of Kazakhstan

British American Tobacco Kazakhstan Trading LLP

Kenya

8 Likoni Road, Industrial Area, P.O. Box 30000-00100, Nairobi, Kenya

African Cigarette Company (Overseas) Limited (100%) (60%) ^

BAT Kenya Tobacco Company Limited (100%) (60%) ^

9 Likoni Road, Industrial Area, P.O. Box 30000-00100, Nairobi, Kenya

British American Tobacco Area Limited

10 Likoni Road, Industrial Area, P.O. Box 30000-00100, Nairobi, Kenya

British American Tobacco Kenya plc (60%)

11 Likoni Road, Industrial Area P.O. Box 30000-00100, Nairobi, Kenya

East African Tobacco Company (Kenya) Limited (100%) (60%) ^

Korea, Republic of

Gangnam Finance Center, 152 Teheran-ro, Gangnam-gu, Seoul, Republic of Korea

British American Tobacco Korea Limited

141, Gongdan1-ro, Sanam-Myun, Sacheon City, Kyungsangnamdo, Republic of Korea

British American Tobacco Korea Manufacturing Limited

Kosovo, Republic of

Llapllaselle, Gracanicë, Republika e Kosoves

TDR shp.p.k. Pristina

Latvia

Mukusalas iela 101, Riga LV-1004, Latvia

British American Tobacco Latvia SIA

Lithuania

Verkiu str. 29, LT 09108 Vilnius, Lithuania

UAB British American Tobacco Lietuva

Luxembourg

2, Avenue Charles de Gaulle, 1653 Luxembourg, Grand Duchy of Luxembourg

British American Tobacco Brands (Switzerland) Limited

Macedonia, Republic of

BOULEVARD "8-mi SEPTEMVRI" No 16 SKOPJE – KARPOSH, KARPOSH, Republic of Macedonia

TDR Skopje d.o.o.e.i. Skopje

Malawi

Northgate Arcade, Highway Chipembere, Blantyre, Malawi

British American Tobacco (Malawi) Limited

Malaysia

Level 8, Symphony House, Block D13, Pusat Dagangan Dana 1, Jalan PJU 1A/46, 47301, Petaling Jaya, Selangor Darul Ehsan, Malaysia

British American Tobacco GSD (Kuala Lumpur) Sdn Bhd

Lot L4-E-1A & 1B, Enterprise 4, Technology Park Malaysia, Lebuhraya Puchong Sg Besi, Bukit Jalil, 57000 Kuala Lumpur, Malaysia

BAT Aspac Service Centre Sdn Bhd

Virginia Park, Jalan Universiti, 46200 Petaling Jaya, Selangor Darul Ehsan, Malaysia

British American Tobacco Malaysia Foundation (viii)

British American Tobacco (Malaysia) Berhad (50%)

Commercial Marketers and Distributors Sdn. Bhd. (100%) (50%) ^

Rothmans Brands Sdn. Bhd. (100%) (50%) ^

The Leaf Tobacco Dev. Corp. of Malaya Sdn. Bhd. (100%) (50%) ^

Tobacco Blenders and Manufacturers Sdn. Bhd. (100%) (50%) ^

Tobacco Importers and Manufacturers Sdn. Bhd. (100%) (50%) ^

Mali

Hippodrome, Rue 249X218, Porte 569, Bamako, BP 2065, Mali

British American Tobacco (Mali) Sarl

Malta

PM Building, Level 2, Mriehel Industrial Zone, Bone Street, Mriehel , BKR3000, Malta

British American Tobacco (Malta) Limited

Central Cigarette Company Limited

Rothmans of Pall Mall (Malta) Limited

Mexico

Francisco I Madero 2750 Poniente, Colonia Centro, Monterrey, Nuevo León, C.P. 64000, Mexico

British American Tobacco Mexico Comercial, S.A. de C.V.

British American Tobacco Mexico Distribuciones, S.A. de CV

British American Tobacco Mexico, S.A. de C.V. (iv)

British American Tobacco Servicios S.A. de C.V.

Cigarrera La Moderna, S.A. de C.V.

Predio Los Sauces Sin número, Colonia Los Sauces, C.P. 63195, Tepic, Nayarit, Mexico

Procesadora de Tabacos de Mexico, S.A. de C.V. (93%)

Moldova, Republic of

65, Stephan cel Mare Str., off. 414-417, Chisinau, MD2001, Republic of Moldova

British American Tobacco–Moldova S.R.L.

Montenegro

Rimski Trg 50, Podgorica, Republic of Montenegro

TDR d.o.o. Podgorica

Mozambique

2290 Avenida de Angola, Maputo, Mozambique

British American Tobacco Mozambique Limitada (95%)

Sociedade Agricola de Tabacos Limitada (95%)

Myanmar

55/56, Schwe Thanlwin, Industrial Zone, Hlaing Thar Yar Township, Yangon, Myanmar

British American Tobacco Myanmar Limited (51%) (x)

British American Tobacco Myanmar Services Limited (x)

Namibia

Shop 48, Second Floor Old Power Station Complex, Armstrong Street, Windhoek, Namibia

British American Tobacco Namibia (Pty) Limited

Netherlands

Handelsweg 53 A, 1181 ZA, Amstelveen, Netherlands

B.A.T Finance B.V.

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

British American Tobacco European Operations Centre B.V.

British American Tobacco Exports B.V.

British American Tobacco Financial Holdings Cooperatief W.A.

British American Tobacco Holdings (Australia) B.V.

British American Tobacco Holdings (Caricom) B.V.

British American Tobacco Holdings (Hong Kong) B.V.

British American Tobacco Holdings (Malaysia) B.V.

British American Tobacco Holdings (South Africa) B.V.

British American Tobacco Holdings (Sri Lanka) B.V.

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

British American Tobacco Holdings (Venezuela) B.V.

British American Tobacco Holdings (Vietnam) B.V.

British American Tobacco International (Holdings) B.V.

British American Tobacco International Europe (Nederland) B.V.

British American Tobacco International Investments B.V.

British American Tobacco Manufacturing B.V.

British American Tobacco Nederland B.V.

British American Tobacco Western Europe Region B.V.

Chic Nederland B.V.

Koninklijke Theodorus Niemeyer B.V.

Molensteegh Invest B.V.

Precis (1789) B.V.

Precis (1790) B.V.

Rothmans Far East B.V.

Rothmans International Holdings B.V.

Rothmans International Holdings II B.V.

Rothmans Tobacco Enterprises B.V.

Rothmans Tobacco Investments B.V.

Rothmans UK Holdings B.V.

Turmac Tobacco Company B.V.

New Zealand

2 Watt Street, Parnell, Auckland, 1052, New Zealand

British American Tobacco (New Zealand) Limited

British American Tobacco Holdings (New Zealand) Limited

25 Princess Street, Palmerston North, New Zealand

New Zealand (UK Finance) Limited #

Bell Gully, Level 22, Vero Centre, 48 Shortland Street, Auckland, 1010, New Zealand

Nicovations New Zealand Limited

Niger

C/O Niger Briques SARL, Grand, Marché Niamey BP2401, Niamey-Niger

British American Tobacco Niger

Nigeria

1, Tobacco Road, Oluyole Toll Gate, Ibadan, Nigeria

British American Tobacco (Nigeria) Limited

Plot PC 35, Idowu Taylor Street, Victoria Island, Lagos, Nigeria

British American Tobacco Exports (Nigeria) Limited

Rising Sun Building, 2 Olumegbon Road, Ikoyi, Lagos, Nigeria

British American Tobacco Marketing Nigeria Limited

Norway

Klaus Torgårdsvej 3, 0372 Oslo, Norway

British American Tobacco Norway AS

Pakistan

Serena Business Complex. Khayaban-e-Suhrwardy, Islamabad, Pakistan

British American Tobacco SAA Services (Private) Ltd

Pakistan Tobacco Company Limited (94.65%)

Phoenix (Private) Limited (100%) (94.65%) ^

Panama

Torre Banco Panama, Boulevard Costa Del Este y Aveida La Rotonda, Piso 14, Oficina 1400, Costa del Este Ciudad de Panama, Panama

BAT Caribbean, S.A.

British American Tobacco Central America S.A. (87.76%)

British American Tobacco Panama S.A.

Tabacalera Istmeña S.A.

Papau New Guinea

Level 4 Mogoru Moto Building, Champion Parade, Port Moresby, NCD, Papua New Guinea

Rothmans of Pall Mall (P.N.G.) Limited (iv)

Level 10 Deloitte Tower, Douglas Street, Port Moresby, NCD, Papau New Guinea

British American Tobacco (PNG) Limited

Papua New Guinea Tobacco Company Limited

Paradise Tobacco Company Pty. Limited (iv)

Paraguay

Avenida Brasilia No 767, Asuncion, Paraguay

British American Tobacco Productora de Cigarrillos S.A.

Group companies and undertakings continued

Peru
Pasaje Santa Rosa 256, Ate, Lima, Perú.
British American Tobacco del Peru Holdings S.A.A. (98.98%) (vi)
British American Tobacco del Peru, S.A.C.

Philippines
6th Floor Tuscan Building, Herrera Street, Legaspi Village, City of Makati, Philippines
Alhambra Industries Inc. #

Poland
Aleja Wojska Polskiego 23c, 63-500, Ostrzeszow, Poland
CHIC SP. ZO.O.
CHIC sp.zo.osp.k.
Nicoventures Polska sp. z.o.o.
eSMOKING Liquids sp.zo.o
eSMOKING Liquids sp.zo.o.sp.k.
Chic Investments sp.zo.o.
Krakowiakow 48, 02-255, Warszawa, Poland
British American Tobacco Polska Trading sp. zo.o.
PLAC ANDERSA 7, 61-894, Poznan, Poland
Chic Holding sp.zo.o
Rubiez 46, 61-612, Poznan, Poland
eSMOKING INSITUTE sp.zo
Ul. Ilzecka 26, 02-135, Warsaw, Poland
Nicoventures Poland Sp. Z.o.o.
Ul. Tytoniowa 16, 16-300, Augustow, Poland
British-American Tobacco Polska S.A.

Portugal
Avenida Engenheiro Duarte Pacheco 26, 7 Piso 1070, Lisboa, Portugal
COTAPO Empreendimentos Commerciais e Industriais S.A.

Réunion
5, Immeuble Cap, Avenue Théodore Drouhet, ZAC Horizon 2000, Le Port, 97420, Ile de la Réunion
B.A.T. La Reunion SAS

Romania
319 Splaiul Independentei, Sema Parc "City Buiding", 1st Floor, 6th Sector, Bucharest, Romania
British American Shared Services (Europe) S.R.L.
Ploiesti, 17-19 Laboratorului Street, Prahova County, Romania
British-American Tobacco (Romania) Investment S.R.L.
Bucharest Business Park - Building B2, 1A Bucuresti - Ploiesti (DN1) Road, Sector 1, Bucharest 013681, Romania
British American Tobacco (Romania) Trading SRL

Russia
197229 Russia, Saint Petersburg, 3rd Konnaya lakhta, 39
CJSC 'British American Tobacco-SPb' #
121614 Russia, Moscow, Krylatskaya st., 17, bld. 2
CJSC 'International Tobacco Marketing Services'

Rwanda
Soras Building, 2nd Flr, Boulevard de la Revolution P.O Box 650 Kigali, Rwanda
British American Tobacco Rwanda Limited

Saint Lucia
c/o ADCO Incorporated, 10 Manoel Street, Castries, Saint Lucia
Carisma Marketing Services Ltd
ries, St Lucia Pointe Seraphine, Castries, Saint Lucia
Rothmans Holdings (Caricom) Limited

Samoa
Vaitele, Apia, Samoa. P.O.Box 1304.
British American Tobacco (Samoa) Limited

Senegal
Almadies, Route Hôtel Méridien en Face Club Med, Dakar, Senegal
Tobacco Marketing Consultant TMC S.A.R.L

Serbia
Bulevar Mihaila Pupina 165G, Belgrade, 11070, Serbia
British American Tobacco South – East Europe d.o.o.
Kralja Stefana Provencanog 209, Vranje, 17500, Serbia
British American Tobacco Vranje a.d. (vii) (88%)
TDR d.o.o. Beograd

Singapore
15 Senoko Loop , Singapore, 758168
Agrega Asia Pacific Pte. Ltd.
British American Tobacco Asia Pacific Treasury Private Limited
British American Tobacco International Services Pte Ltd
British-American Tobacco (Singapore) Private Limited
British-American Tobacco Marketing (Singapore) Private Limited
Rothmans Industries Private Limited
18 Ah Hood Road #12-51, Hiap Hoe Bldg at Zhongshan Park, Singapore, 329983
British American Tobacco Sales & Marketing Singapore Pte. Ltd.
RHL Investments Pte Limited #

Slovenia
Bravničarjeva ulica 13, 1000 Ljubljana, Slovenia
British American Tobacco d.o.o.
TDR Rovita d.o.o. Liubliana

Solomon Islands
Kukum Highway, Ranadi, Honiara, Honiara, Solomon Islands
Solomon Islands Tobacco Company Limited

South Africa
Waterway House South, 3 Dock Road, V&A Waterfront, Cape Town 8000, South Africa
Agrega EEMEA (Pty) Limited
Amalgamated Tobacco Corporation (South Africa) (Pty) Limited
American Cigarette Company (Overseas) Ltd.
Benson & Hedges (Pty) Limited
British American Shared Services Africa Middle East (Pty) Limited
British American Tobacco GSD (South Africa) (Pty) Limited
British American Tobacco Holdings South Africa (Pty) Limited #
British American Tobacco Manufacturers South Africa (Pty) Ltd.
British American Tobacco Properties South Africa (Pty) Ltd.
British American Tobacco Services South Africa (Pty) Limited
British American Tobacco South Africa (Pty) Limited
British American Tobacco Southern Africa Markets (Pty) Limited
Brown & Williamson Tobacco Corporation (Pty) Limited
Business Venture Investments No 216 (Pty) Limited
Carlton Cigarette Company (Pty) Limited
Gauloises (Pty) Limited
Intercontinental Tobacco Company (Pty) Ltd.
John Chapman (Pty) Limited
John Player & Sons (Pty) Limited
Kentucky Tobacco Corporation (Pty) Limited
Martins of London (Pty) Limited
Rembrandt Tobacco Corporation (Overseas) Ltd
Riggio Tobacco Corporation of New York Ltd

Rothmans of Pall Mall London Limited
St. Regis Tobacco Corporation Ltd
Stellenbosch Development Company (Pty) Limited
Thomas Bear's Son & Co (Pty) Limited
Tobacco Research and Development Institute (Pty) Limited
W.D. & H.O. Wills (Pty) Limited
Westminster Tobacco Company (Cape Town & London) (Pty) Limited
Winfield Tobacco Corporation (Pty) Limited
Winston Tobacco Company Limited

Spain

Torreo Espacio, Paseo de la Castellana, 259D, 28046 Madrid, Spain
British American Tobacco España, S.A.

Sri Lanka

178 Srimath Ramanathan Mawatha, Colombo, 15, Sri Lanka
Ceylon Tobacco Company Plc (84.13%)

Sudan

Gomhoreya Street, Khartoum, Sudan, PO Box 1381
Blue Nile Cigarette Company Limited

Swaziland

Rhus Office Park, Kal Grant Street, P.O. Box 569, Mbabane, Swaziland
British American Tobacco Swaziland (Pty) Limited

Sweden

Warfvinges väg 35, 112 51 Stockholm, Sweden
British American Tobacco Sweden AB
British American Tobacco Sweden Holding AB
Stenåldersgatan 23, 213 76 Malmö, Sweden
Fiedler & Lundgren AB

Switzerland

Zählerweg 4, 6300 Zug, Switzerland
AD Tabacs International S.A.
American-Cigarette Company (Overseas) Limited
British American Tobacco International Limited
Rothmans of Pall Mall Limited
Route de France 17, 2926 Boncourt, Switzerland
British American Tobacco Switzerland S.A.
British American Tobacco Switzerland Vending SA
Route de la Glâne 107, c/o NBA Fiduciaire S.A. 1752 Villars-sur-Glâne, Switzerland
Intertab S.A. (50%)

Tanzania

Acacia Estate Building, Kinondoni Rd, P.O. Box 72484, Dar es Salaam, Tanzania
BAT Distribution Tanzania Limited
British American Tobacco (Tanzania) Limited
International Cigarette Distributors Limited (99%)
Zanzibar Distribution Company Limited (99%)

Thailand

No. 179/74-80 Bangkok City Tower, 15th Floor, South Sathorn Road, Thungmahamek Sub-District, Sathorn District, Bangkok, Thailand
British American Tobacco (Thailand) Limited

Trinidad and Tobago

Corner Eastern Main Road and Mt. D'or Road, Champs Fleurs, Trinidad and Tobago
The West Indian Tobacco Company Limited (50.13%)

Turkey

Veko Giz Plaza, Meydan Street, No: 3, B Blok, Floor: 18, Maslak, Sariyer, Istanbul, Turkey
British American Tobacco Tütün Mamulleri Sanayi ve Ticaret Anonim Sirketi

Uganda

7th Floor TWED Towers, Plot 10, Kafu Road, Nakasero, P.O. Box 7100, Kampala, Uganda
British American Tobacco Uganda Limited (90%)

Ukraine

13-15 Bolsunovska Str, Kyiv, 01014 Ukraine
LLC "British American Tobacco Sales and Marketing Ukraine"
21 Nezalezhnosti Str, Pryluky, Chernihiv Region, 17502 Ukriane
PJSC "A/T B.A.T. – Prilucky Tobacco Company" (99.99%)

United Arab Emirates

Office No. 201-212, Building 10, Second Floor, Dubai Internet City, Dubai, United Arab Emirates
British American Tobacco FZ-LLC
Jumeriah Business Centre 3, 37th Floor, Jumeirah Lake Towers, Dubai, P.O. Box 337222, United Arab Emirates
British American Tobacco GCC DMCC
British American Tobacco ME DMCC

United Kingdom

212-218 Upper Newtownards Road, Belfast, BT4 3ET, Northern Ireland
Murray, Sons & Company, Limited
7 More London, Riverside, London, SE1 2RT, United Kingdom
Ryesekks P.L.C. (50%)
Globe House, 1 Water Street, London, WC2R 3LA, United Kingdom
Advanced Technologies (Cambridge) Limited
Agrega Limited
Allen & Ginter (UK) Limited
B.A.T (U.K. and Export) Limited
B.A.T Cambodia (Investments) Limited
B.A.T Far East Development Limited
B.A.T Far East Holding Limited
B.A.T Far East Leaf Limited
B.A.T Guangdong Limited
B.A.T Guizhou Limited
B.A.T Portugal Limited
B.A.T Russia Limited
B.A.T Services Limited
B.A.T Uzbekistan (Investments) Limited
B.A.T Vietnam Limited
B.A.T. (Westminster House) Limited
B.A.T. China Limited
BAT Finance COP Limited
BATIF Dollar Limited
BATUS Limited
Big Ben Tobacco Company Limited
British American Shared Services (GSD) Limited
British American Shared Services Limited
British American Tobacco (AIT) Limited
British American Tobacco (AME) Exports Limited
British American Tobacco (GLP) Limited
British American Tobacco (Investments) Limited
British American Tobacco (Philippines) Limited
British American Tobacco (Serbia) Limited
British American Tobacco (South America) Limited

Financial Statements

Group companies and undertakings continued

British American Tobacco China Holdings Limited
British American Tobacco Georgia Limited
British American Tobacco Global Travel Retail Limited
British American Tobacco International Holdings (UK) Limited
British American Tobacco Investments (Central & Eastern Europe) Limited
British American Tobacco Italy Investments Limited
British American Tobacco Italy Limited
British American Tobacco Korea (Investments) Limited
British American Tobacco Malaysia (Investments) Limited
British American Tobacco Peru Holdings Limited
British American Tobacco UK Pension Fund Trustee Limited (x)
British American Tobacco Western Europe Commercial Trading Limited
British-American Tobacco (Mauritius) p.l.c.
Carreras Rothmans Limited #
Chelwood Trading & Investment Company Limited
East African Tobacco Company (U.K.) Limited
Lord Extra Limited
Myddleton Investment Company Limited
Nicovations Limited
Nicoventures Holdings Limited
Nicoventures Trading Limited
Powhattan Limited
Precis (2396) Limited
Ridirectors Limited
Rothmans (UK) Trading Limited
Rothmans Exports Limited
Rothmans International Limited
Rothmans International Tobacco (UK) Limited
Rothmans International Services Limited
Rothmans of Pall Mall (Overseas) Limited
Rothmans Trading Limited
Ryservs (1995) Limited
Ryservs (No.3) Limited
Ten Motives Limited
Tobacco Exporters International Limited
Tobacco Marketing Consultants Limited
Venezuela Property Company Limited
Westanley Trading & Investment Company Limited
Westminster Tobacco Company Limited
10 Motives Limited

Globe House, 2 Milford Lane, London, WC2R 3LN, United Kingdom
World Investment Company Limited

Globe House, 4 Temple Place, London, WC2R 2PG, United Kingdom
Amalgamated Tobacco Company Limited
American Cigarette Company (Overseas) Limited
Ardath Tobacco Company Limited
B.A.T Additional Retirement Benefit Scheme Trustee Limited
B.A.T Industries p.l.c.
B.A.T. International Finance p.l.c. *
BATLaw Limited
BATMark Limited *
Benson & Hedges (Overseas) Limited
British American Global Shared Services Limited
British American Tobacco (1998) Limited *
British American Tobacco (2009) Limited
British American Tobacco (2009 PCA) Limited
British American Tobacco (2012) Limited
British American Tobacco (Brands) Limited
British American Tobacco (Corby) Limited
British American Tobacco (NGP) Limited
British American Tobacco Taiwan Logistics Limited
British American Ventures Limited
British-American Tobacco (Holdings) Limited
Brown & Williamson Tobacco Corporation (Export) Limited
Carreras Limited
CG Ventures Limited
Courtleigh of London Limited
Dunhill Tobacco of London Limited
John Sinclair Limited
Louisville Securities Limited
Moorgate Tobacco Co. Limited
Peter Jackson (Overseas) Limited
Precis (1789) Limited
Precis (1790) Limited
Precis (1814) Limited
Rothmans International Enterprises Limited
Rothmans of Pall Mall Limited
Senior Service (Overseas) Limited
South Western Nominees Limited
The London Tobacco Company Limited
Tobacco Insurance Company Limited
Weston (2009) Limited
Weston Investment Company Limited

One, Eton Street, Richmond Upon Thames, London, TW9 1EF, United Kingdom
British American Tobacco UK Limited

United States

2711 Centerville Road, Suite 400, Wilmington DE 19808, United States
BTI 2014 LLC

Corporation Service Company, 2711 Centerville Road, Suite 400, Wilmington Delaware 19808, United States
B.A.T Capital Corporation
BATUS Holdings Inc.
BATUS Japan, INC.
BATUS Retail Services, Inc.
British American Tobacco (Brands) Inc.
Brown & Williamson Holdings, Inc.
Imasco Holdings Group, Inc.
Imasco Holdings, Inc.
ITL (USA) Limited
Louisville Corporate Services, Inc.
Nicoventures U.S. Limited

CSC-Lawyers Incorporating Service, 2710 Gateway Oaks Drive, Suite 150N, Sacramento CA 95833-3505, United States
Genstar Pacific Corporation

Uruguay

Juncal 1392, Montevideo, Uruguay
Kellian S.A.

Uzbekistan

77 Minor Passage, Tashkent, 100084, Uzbekistan
UZBAT A.O. (97.38%)

Venezuela

Registro Mecantil Primero de la Circunscripción, Judical des Distrito, Capital y Estado, Miranda, Venezuela

Agrega de Venezuela, Agreven, C.A. (50%)

Agrobigott, C.A.

Avenida Francisco de Miranda, Edificio Bigott, Los Ruices, Caracas – Estado Miranda, 1010, Venezuela

Compania Anonima Cigarrera Bigott Sucesores

Distribuidora Bigott, C.A.

Avenida Francisco de Miranda, Torre Regelfall, Municipio Chacao, Estado, Miranda, Caracas, Venezuela

Proyectos de Inversion BAT 1902 C.A.

Vietnam

20/F Kumho Asiana Plaza, 39 Le Duan Street, Ben Nghe ward, District 1, Ho Chi Minh City, Vietnam

British American Tobacco East Asia Area Services Company Limited

Area 8, Long Binh Ward, Bien Hoa City, Dong Nai Province, Vietnam

British American Tobacco – Vintaba Limited (70%)

Lot 45C/I, Road #7, Vinh Loc Industrial Park, Binh Chanh District, Ho Chi Minh City, Vietnam

VINA-BAT Joint Venture Company (49%)

Zambia

20992 Kafue Road, P O Box 30622, Lusaka, Zambia

British American Tobacco (Zambia) plc (78.08%)

Zimbabwe

Manchester Road 1, Southerton, Harare, Zimbabwe

American-Cigarette Company (Overseas) (Private) Ltd

Rothmans Limited

Associated Undertakings and Joint Ventures

Angola

Viana Park, Polo Industrial, Viana, Luanda, Angola

Agrodande Limitada (32.50%)

Soc. Filtros Angola Sarl (39.14%)

Argentina

San Martín 140, Floor 14, City of Buenos Aires, Argentina

Agrega S.A. (75%) (43.74%) ^

Bosnia and Herzegovina

Drage Karamana bb, 75000 Tuzla, Bosnia and Herzegovina

Uncro Team d.o.o. (100%) (24.36%) ^

Fra Dominka Mandića 24 A, 88220 Široki Brijeg, Bosnia and Herzegovina

Ipress d.o.o. Široki Brijeg (51%) (49.70%) ^

Krstine bb, 88260 Čitluk, Bosnia and Herzegovina

Satelit-Plus d.o.o. Čitluk (25%) (24.36%) ^

Viteza Mile Bošnjaka br. 32, 88240 Posušje, Bosnia and Herzegovina

Pos d.o.o. Posušje (100%) (24.36%) ^

Croatia

Slavonska avenija 11a, 10000 Zagreb, Croatia

Tisak d.d. (41.86%)

Hungary

H-6800 Hódmezővásárhely, Erzsébeti út 5/b, Hungary

Országos Dohányboltellátó Korlátolt Felelosségu Társaság (49%)

India

Virginia House, 37, J.L. Nehru Road, Kolkata, 700 071, India

ITC Limited (29.89%) (x)

Azamabad, Andhra Pradesh, Hyderabad, 500 020, India

VST Industries Limited (32.16%) (x)

Nepal

Shree Bal Sadan, Gha 2-513, Kantipath, Kathmandu, Nepal

Surya Nepal Pvt. Limited (61%) (19.65%) ^(xi)

Nigeria

1, Tobacco Road, Oluyole Toll Gate, Ibadan, Nigeria

Nigerpak Limited (26%) (ix)

Serbia

Kralja Stefana Provencanog 209, Vranje, 17500, Serbia

Veletabak d.o.o. (25%)

Uganda

7th Floor TWED Towers, Plot 10, Kafu Road, Nakasero, P.O. Box 7100, Kampala, Uganda

Uganda Tobacco Processors Limited (50%)

United States

Corporation Service Company, 2711 Centerville Road, Suite 400, Wilmington Delaware 19808, United States

Reynolds American Inc. (42.18%)

Yemen

P.O. Box 14, Sanna, Yemen

Kamaran Industry and Investment Company (31%)

P.O. Box 5302, Hoban, Taiz, Yemen

United Industries Company Limited (32%)

Zimbabwe

Manchester Road 1, Southerton, Harare, Zimbabwe

British American Tobacco Zimbabwe (Holdings) Limited (43.13%)

Rothmans of Pall Mall (Malawi) Limited (100%) (43.13%) ^(x)

Joint Operations

Hong Kong

29/F, Oxford House, 979 King's Road, Taikoo Place, Quarry Bay, Hong Kong

CTBAT International Co. Limited (50%)

Notes:

(i) Ownership held in the class of USD 100 (100%) (76.30%)^ and USD 49,900 (100%).

(ii) Ownership held in the class of Series F and 2nd Preferred shares.

(iii) Ownership held in the class of A shares (50%) and class of B shares (100%).

(iv) Ownership held in class of A shares and B shares.

(v) Ownership held solely in class of preference shares.

(vi) Ownership held in class of Investment stock (98.98%) and Ordinary shares (98.35%).

(vii) Ownership held in class of A (92.38%), B (83.98%), C (99.89%) and D (99.97%) Ordinary shares.

(viii) Company limited by guarantee.

(ix) 28 February year-end.

(x) 31 March year-end.

(xi) 15 July year-end.

(xii) 30 November year-end.

Financial Statements

Balance Sheet

British American Tobacco p.l.c. – At 31 December

	Notes	2016 £m	2015 £m
Assets			
Fixed assets			
Investments in Group companies	2	**4,446**	4,415
		4,446	4,415
Current assets			
Debtors	3	**7,289**	7,371
Cash at bank and in hand		**5**	3
Total current assets		**7,294**	7,374
Total assets		**11,740**	11,789
Equity			
Capital and reserves			
Called up share capital		**507**	507
Share premium account		**82**	78
Capital redemption reserves		**101**	101
Other reserves		**90**	90
Profit and loss account		**7,105**	7,116
after deducting			
– cost of treasury shares		**(5,036)**	(5,032)
Shareholders' funds	4	**7,885**	7,892
Liabilities			
Creditors	5	**3,855**	3,897
Total equity and liabilities		**11,740**	11,789

The accompanying notes are an integral part of the Parent Company financial statements.

On behalf of the Board

Richard Burrows
Chairman

22 February 2017

Financial Statements

Statement of Changes in Equity

British American Tobacco p.l.c. – At 31 December

	Notes	Share capital £m	Share premium account £m	Capital redemption reserves £m	Other reserves £m	Retained earnings £m	Total equity £m
Balance at 1 January 2016		**507**	**78**	**101**	**90**	**7,116**	**7,892**
Profit for the year		–	–	–	–	2,905	2,905
Increase in capital – Employee share options		–	4	–	–	–	4
Dividends and other appropriations – ordinary shares		–	–	–	–	(2,910)	(2,910)
Purchase of own shares							
– held in employee share ownership trusts		–	–	–	–	(63)	(63)
Other movements		–	–	–	–	57	57
Balance at 31 December 2016		**507**	**82**	**101**	**90**	**7,105**	**7,885**

	Notes	Share capital £m	Share premium account £m	Capital redemption reserves £m	Other reserves £m	Retained earnings £m	Total equity £m
Balance at 1 January 2015		507	74	101	90	8,902	9,674
Profit for the year		–	–	–	–	961	961
Increase in capital – Employee share options		–	4	–	–	–	4
Dividends and other appropriations – ordinary shares		–	–	–	–	(2,770)	(2,770)
Purchase of own shares							
– held in employee share ownership trusts		–	–	–	–	(44)	(44)
Other movements		–	–	–	–	67	67
Balance at 31 December 2015		507	78	101	90	7,116	7,892

There was no difference between profit and loss for the period and total comprehensive income for the period.

Financial Statements

Notes on the Accounts

1 Accounting policies

Basis of accounting

The financial statements of the Parent Company have been prepared in accordance with Financial Reporting Standard 101 Reduced Disclosure Framework ("FRS 101").

In preparing these financial statements, the Company applies the recognition, measurement and disclosure requirements of International Financial Reporting Standards as adopted by the EU ("IFRS"), but makes amendments where necessary in order to comply with Companies Act 2006 and where advantage of certain disclosure exemptions available under FRS 101 have been taken, including those relating to:

– a cash flow statement and related notes;

– comparative period reconciliations;

– disclosures in respect of transactions with wholly owned subsidiaries;

– disclosures in respect of capital management;

– the effects of new but not yet effective IFRSs; and

– disclosures in respect of the compensation of key management personnel.

As the consolidated financial statements of the Group include equivalent disclosures, the Company has also taken the exemptions under FRS 101 available in respect of disclosures under IFRS 2 related to group settled share based payments.

The preparation of the financial statements requires the Directors 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.

As permitted by Section 408 of the Companies Act 2006, the profit and loss of the Company has not been presented in these financial statements.

The Company is a public limited company which is listed on the London Stock Exchange and the Johannesburg Stock Exchange and is incorporated and domiciled in the UK.

Foreign currencies

The functional currency of the Company is sterling. Transactions arising in currencies other than sterling are translated at the rate of exchange ruling on the date of the transaction. Assets and liabilities expressed in currencies other than sterling are translated at rates of exchange ruling at the end of the financial year. All exchange differences are taken to the profit and loss account in the year.

Revenue

Revenue and other income are included in the profit and loss account when all contractual or other applicable conditions for recognition have been met. Allowances are made for bad and doubtful debts, as appropriate.

Taxation

Taxation is that chargeable on the profits for the period, together with deferred taxation. Income tax charges, where applicable, are calculated on the basis of tax laws enacted or substantively enacted at the balance sheet date.

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. As required under IAS 12 *Income Taxes*, deferred tax assets and liabilities are not discounted.

Investments in Group companies

Investments in Group companies are stated at cost, together with subsequent capital contributions, less provisions for any impairment in value, where appropriate.

Dividends

Final dividend distributions to the Company's shareholders are recognised as a liability in the financial statements in the period in which the dividends are approved by the Company's shareholders while the interim dividend distributions are recognised in the period in which the dividends are declared and paid.

Similarly, dividend income is recognised at the same time as the paying company recognises the liability to pay a dividend.

Repurchase of share capital

When share capital is repurchased, the amount of consideration paid, including directly attributable costs, is recognised as a deduction from equity. Repurchased shares which are not cancelled, or shares purchased for the employee share ownership trusts, are classified as treasury shares and presented as a deduction from total equity.

Related parties

The Company has taken advantage of the exemption under FRS 101 from disclosing transactions with related parties that are wholly owned subsidiaries of British American Tobacco p.l.c. Group.

Financial instruments

Financial guarantees are initially recorded at fair value, and subsequently carried at this fair value less accumulated amortisation.

Share-based payments

The Company has equity-settled share-based compensation plans.

Equity-settled share-based payments are measured at fair value at the date of grant. The fair value determined at the grant date of the equity-settled share-based payments is expensed over the vesting period, based on the Group's estimate of awards that will eventually vest. For plans where vesting conditions are based on total shareholder returns, the fair value at date of grant reflects these conditions, whereas earnings per share vesting conditions are reflected in the calculation of awards that will eventually vest over the vesting period.

Fair value is measured by the use of the Black-Scholes option pricing model, except where vesting is dependent on market conditions when the Monte-Carlo option pricing model is used. The expected life used in the models has been adjusted, based on management's best estimate, for the effects of non-transferability, exercise restrictions and behavioural considerations.

2 Investments in Group companies

The Company's directly wholly-owned subsidiaries are British American Tobacco (1998) Limited, B.A.T. International Finance p.l.c. and BATMark Limited. A full list of indirect subsidiaries and other undertakings as required by Section 409 of the Companies Act 2006 is shown on pages 153 to 161 of the Group financial statements.

In 2016, the Company sold its investment in B.A.T. Capital Corporation to Louisville Securities Limited, an indirect subsidiary of the Company.

The Directors are of the opinion that the individual investments in the subsidiary undertakings have a value not less than the amount at which they are shown in the balance sheet.

	2016 £m	2015 £m
1 January	**4,415**	4,356
Additions	**37**	59
Disposals	**(6)**	–
31 December	**4,446**	4,415

3 Debtors

	2016 £m	2015 £m
Amounts due from Group undertakings	**7,289**	7,371
Current	**7,289**	7,327
Non-current	**–**	44
31 December	**7,289**	9,116

Included within amounts due from Group undertakings is an amount of £7,275 million (2015: £7,309 million) which is unsecured, interest bearing and repayable on demand. The interest rate is based on LIBOR.

Amounts totalling £14 million (2015: £18 million) due from Group undertakings are unsecured, interest free and repayable on demand.

4 Shareholders' funds

Dividends paid are recognised in the year in which they are approved by shareholders, and dividends received are recognised in the year in which they are received. The final dividend which has been declared for the year ended 31 December 2016 is shown in note 8 to the Group financial statements and will be recognised in the financial statements for the year ended 31 December 2017.

As permitted by Section 408 of the Companies Act 2006, the profit and loss of the Company has not been presented in these financial statements. The profit for the year ended 31 December 2016 was £2,905 million (2015: £961 million).

Details of Directors' remuneration, share options and retirement benefits are given in the remuneration report. Details of key management compensation are included in note 27 of the Group financial statements. The Company had two employees at 31 December 2016 (2015: two). These two employees are Nicandro Durante and Ben Stevens. The details of their remuneration are shown on pages 60 and 61 of the Group financial statements respectively. The costs of these employees are borne by another Group company.

Shareholders' funds are stated after deducting the cost of treasury shares which include £4,845 million (2015: £4,845 million) for shares repurchased and not cancelled and £191 million (2015: £187 million) in respect of the cost of own shares held in employee share ownership trusts.

As at 31 December 2016 treasury shares include 5,137,602 (2015: 5,356,084) of shares held in trust and 162,645,590 (2015: 162,645,590) of shares repurchased and not cancelled as part of the Company's share buy-back programme.

Other movements in shareholders' funds principally relate to the release of treasury shares as a result of the exercise of share options.

Called up share capital	Ordinary shares of 25p each Number of shares	£m
Allotted and fully paid		
1 January 2016	**2,026,866,724**	**506.71**
Changes during the year		
– share option schemes	**152,784**	**0.04**
31 December 2016	**2,027,019,508**	**506.75**

Notes on the Accounts continued

4 Shareholders' funds continued

Called up share capital	Ordinary shares of 25p each Number of shares	£m
Allotted and fully paid		
1 January 2015	2,026,693,029	506.67
Changes during the year		
– share option schemes	173,695	0.04
31 December 2015	2,026,866,724	506.71

Share premium

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.

5 Creditors

	2016 £m	2015 £m
Amounts due to Group undertakings	**73**	64
Loans due to Group undertakings	**3,618**	3,617
Other creditors	**156**	208
Deferred Income	**8**	8
	3,855	3,897
Current	**3,733**	108
Non-current	**122**	3,789
31 December	**3,855**	3,897

Amounts due to Group undertakings of £73 million (2015: £64 million) are unsecured, interest free and repayable on demand.

Loans due to Group undertakings of £3,618 million (2015: £3,617 million) are unsecured, bear interest at rates between 1.77% and 1.94% (2015: 1.92% and 1.94%) and are repayable in 2017.

Other creditors includes financial guarantees of £136 million (2015: £191 million) of which £114 million (2015: £164 million) falls due after more than one year. As disclosed in note 7 the Company has guaranteed borrowings by subsidiary undertakings.

Deferred income shown above relates to the Company's share of receipts in respect of the Franked Investment Income Government Litigation Order ("FII GLO"). As described in note 6(b) to the Group financial statements, the Group received £963 million from HM Revenue & Customs. The payment was received subject to on-going appeals process and was made with no admission of liability.

6 Audit fees

	2016	2015
Fees payable to KPMG LLP		
– Audit fees	**£30,000**	£30,000
– Fees paid for other services	**£nil**	£nil

7 Contingent liabilities and financial commitments

British American Tobacco p.l.c. has guaranteed borrowings by subsidiary undertakings of £17.9 billion (2015: £15.8 billion) and total borrowing facilities of £25.2 billion (2015: £21.5 billion).

The Company has cross-guaranteed the liabilities of the British American Tobacco UK Pension Fund which had a deficit according to the last formal triennial actuarial valuation in March 2014 of £264 million and which had a surplus on an IAS 19 basis at 31 December 2016 of £342 million (2015: £311 million).

In addition, there are contingent liabilities in respect of litigation in various countries (note 28 to the Group financial statements).

Shareholder and contact information

Listings and shareholder services

Premium listing

London Stock Exchange (Share Code: BATS; ISIN: GB0002875804)

United Kingdom Registrar

Computershare Investor Services PLC
The Pavilions, Bridgwater Road, Bristol BS99 6ZZ
tel: 0800 408 0094; +44 370 889 3159
web-based enquiries: www.investorcentre.co.uk/contactus

www.computershare.com/uk/investor/bri

Access the web-based enquiry service of Computershare Investor Services PLC for holders of shares on the UK share register; view details of your British American Tobacco shareholding and recent dividend payments and register for shareholder electronic communications to receive notification of British American Tobacco shareholder mailings by email.

www.computershare.com/dealing/uk

Go online or telephone 0370 703 0084 (UK) to buy or sell British American Tobacco shares traded on the London Stock Exchange. The internet share dealing service is only available to shareholders resident in countries in the European Economic Area.

Secondary listing

JSE (Share Code: BTI)

Shares are traded in electronic form only and transactions settled electronically through Strate.

South Africa Registrar

Computershare Investor Services Proprietary Limited
PO Box 61051, Marshalltown 2107, South Africa
tel: 0861 100 634; +27 11 870 8216
email enquiries: web.queries@computershare.co.za

American Depositary Receipts

NYSE MKT (Symbol: BTI; CUSIP No. 110448107)

British American Tobacco sponsors an American Depositary Receipt (ADR) programme in the United States. Each ADR represents one ordinary share.

Enquiries regarding ADR holder accounts and payment of dividends should be directed to:

Citibank Shareholder Services
PO Box 43077, Providence, Rhode Island 02940-3077, USA
tel: 1-888 985-2055 (toll-free) or +1 781 575 4555
email enquiries: citibank@shareholders-online.com
website: www.citi.com/dr

Publications

Copies of current and past Annual Reports are available on request. Copies of the Group corporate brochure, We are BAT, are also available. Highlights from these publications can be produced in alternative formats such as Braille, audio tape and large print.

Contact:
British American Tobacco Publications
Unit 80, London Industrial Park, Roding Road, London E6 6LS
tel: +44 20 7511 7797; facsimile: +44 20 7540 4326
email: bat@team365.co.uk

Holders of shares held on the South Africa register can contact the Company's Representative office in South Africa using the contact details shown overleaf.

Our website – www.bat.com

Access comprehensive information about British American Tobacco and download shareholder publications at the corporate website; visit the Investors section for valuation and charting tools, dividend and share price data and subscribe to the email alert services for key financial events in the British American Tobacco financial calendar; download the British American Tobacco Investor Relations app to access all the latest financial information on your iPad, iPhone or Android device.

Dividend Reinvestment Plan

Available to the majority of shareholders on the UK register, this is a straightforward and economic way of utilising your dividends to build up your shareholding in British American Tobacco. Contact Computershare Investor Services PLC in the UK for details.

Individual Savings Accounts (ISAs)

A British American Tobacco sponsored ISA.

Contact:
The Share Centre
PO Box 2000, Aylesbury, Bucks HP21 8ZB
tel: 0800 800 008; +44 1296 414 141
email enquiries: service@share.co.uk
website: www.share.com

(The tax advantages of ISAs depend on your individual circumstances and the benefits of ISAs could change in the future. You should note that investments, their value and the income they provide can go down as well as up and you might not get back what you originally invested.)

Capital gains tax

Fact sheet for British American Tobacco historical UK capital gains tax information; contact the British American Tobacco Company Secretarial Department, tel: +44 20 7845 1000 or access online at www.bat.com/cgt

Shareholder and contact information continued

Final dividend 2016 – dates in 2017

Please see 'Other corporate disclosures' (page 77) for further details.

23 February	Dividend announced (including amount of dividend per share in both sterling and rand, applicable exchange rate and conversion date – 21 February 2017; plus additional applicable information as required in respect of South Africa Dividends Tax)
23 February to 17 March	From the commencement of trading on 23 February to 17 March 2017 (inclusive), no removal requests in either direction between the UK main register and the South Africa branch register will be permitted
14 March	Last day to trade (JSE)
15 March to 17 March	From the commencement of trading on 15 March to 17 March 2017 (inclusive), no transfers between the UK main register and the South Africa branch register; no shares may be dematerialised or rematerialised
15 March	Ex-dividend date (JSE)
16 March	Ex-dividend date (LSE)
17 March	Record date (LSE and JSE)
10 April	Last date for receipt of Dividend Reinvestment Plan (DRIP) elections (UK main register only)
4 May	Payment date (sterling and rand)

Future Payment of Dividends – Mandatory Direct Credit

From 2018, British American Tobacco is simplifying the way in which it pays dividends to shareholders by only paying cash dividends directly into a shareholder's nominated bank account. This is known as mandatory direct credit. British American Tobacco will no longer be issuing dividend cheques. Shareholders recorded on the main register as receiving dividend payments by cheque have been or will be advised by Computershare. Those shareholders will need to take the required action by selecting the appropriate option as set out in the Computershare notification.

Shareholders on the UK main register who already have their dividends paid: (1) by direct credit into their UK bank or building society account; or (2) through the Euroclear service using the CREST messaging system; or (3) through Computershare's Global Payments Service (GPS) are not affected by this change. Similarly, shareholders who participate in the British American Tobacco Dividend Reinvestment Plan (DRIP) are not required to take any action unless they choose to withdraw from the DRIP.

For the South Africa branch register, Computershare South Africa will notify affected shareholders of the equivalent applicable arrangements for the payment of dividends, as appropriate.

Financial calendar 2017

26 April	Annual General Meeting Milton Court Concert Hall, Silk Street, London EC2Y 9BH
27 July	Half-Year Report

Analyses of shareholders

The high and low prices at which the Company's shares are recorded as having traded during the year on each of the LSE and the JSE are as follows:

	High	Low
LSE	£51.35	£35.36
JSE	R987.39	R728.20

At 31 December 2016 there was a total of 2,027,019,508 ordinary shares in issue held by 116,610 shareholders. These shareholdings are analysed as follows:

(a) by listing as at 31 December 2016:

Register	Total number of shares	Percentage of issued share capital	Number of holders
UK	1,769,948,816	87.32	40,965
South Africa	257,070,692	12.68	75,645

(b) by category of shareholder and size of shareholding as at 31 December 2016, being the date on which equivalent information was available on both registers:

UK Register

Category of UK shareholder	Number of UK holders	Percentage of total UK holders	Number of UK ordinary shares	Percentage of UK ordinary share capital
Individuals	35,712	87.18	37,296,346	2.11
Financial institutions/ Pension funds	246	0.60	6,402,583	0.36
Nominee companies	4,801	11.72	1,558,808,756	88.07
Other corporate holders	205	0.50	4,795,541	0.27
Treasury shares (UK)	1	<0.01	162,645,590	9.19

South Africa Register

Category of SA shareholder	Number of SA holders	Percentage of total SA holders	Number of SA ordinary shares	Percentage of SA ordinary share capital
Individuals	56,407	74.57	24,886,652	9.68
Financial institutions/ Pension funds	2,566	3.39	171,462,917	66.70
Nominee companies	14,195	18.77	48,548,679	18.89
Other corporate holders	2,477	3.27	12,172,444	4.73

Combined Registers

Category of shareholder	Number of holders	Percentage of total holders	Number of ordinary shares	Percentage of issued ordinary share capital
Individuals	92,119	79.00	62,182,998	3.07
Financial institutions/ Pension funds	2,812	2.41	177,865,500	8.77
Nominee companies	18,996	16.29	1,607,357,435	79.30
Other corporate holders	2,682	2.30	16,967,985	0.84
Treasury shares (UK)	1	<0.01	162,645,590	8.02

UK Register

	Number of holders	Percentage of UK ordinary share capital
1 – 1,999	34,449	0.88
2,000 – 9,999	4,745	1.02
10,000 – 199,999	1,272	3.79
200,000 – 499,999	206	3.69
500,000 and over	292	81.43
Treasury shares (UK)	1	9.19

South Africa Register

	Number of holders	Percentage of SA ordinary share capital
1 – 1,999	69,502	7.48
2,000 – 9,999	4,331	6.81
10,000 – 199,999	1,658	24.73
200,000 – 499,999	89	9.94
500,000 and over	65	51.04

Combined Registers

	Number of holders	Percentage of issued ordinary share capital
1 – 1,999	103,951	1.72
2,000 – 9,999	9,076	1.75
10,000 – 199,999	2,930	6.44
200,000 – 499,999	295	4.49
500,000 and over	357	77.58
Treasury shares (UK)	1	8.02

Registered office

Globe House, 4 Temple Place, London WC2R 2PG
tel: +44 20 7845 1000, facsimile: +44 20 7240 0555
Incorporated in England and Wales No. 3407696

Representative Office in South Africa

Waterway House South, No 3 Dock Road, V&A Waterfront,
Cape Town 8000, South Africa
PO Box 631, Cape Town 8000, South Africa
tel: +27 21 003 6576

Secretary *(until 30 April 2017)*

Nicola Snook

Secretary Designate *(Secretary from 1 May 2017)*

Paul McCrory

General Counsel

Jerome Abelman

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Press office

Enquiries should be directed to Anna Vickerstaff
tel: +44 20 7845 2888
email: press_office@bat.com

Auditors

KPMG LLP
15 Canada Square, Canary Wharf, London E14 5GL

References in this publication to 'British American Tobacco', 'BAT', 'we', 'us', and 'our' when denoting opinion refer to British American Tobacco p.l.c. (the Company) (No. 3407696) and when denoting tobacco business activity refer to British American Tobacco Group operating companies, collectively or individually as the case may be.

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